Cut Your Tax Bill

A "Dummies" Guide

INTRODUCTION

OK, I know that tax is not a bundle of laughs, and that most of us would probably prefer to visit our dentist rather than completing our Tax Return, but the fact of the matter is that taxation has a **huge influence** on our standard of living.

We pay tax in many different ways - income tax, national insurance contributions, value added tax, capital gains tax, inheritance tax, council tax, excise duties, car tax, stamp duty…. The list is virtually endless! Through these taxes, each and every person in the UK pays an average of nearly 50% of their income to the Government in tax.

50%!

Putting this another way, the average UK taxpayer effectively works from 1 January to 30 June each year for the Government. And only after this date does the UK taxpayer earn money for him or her self.

And these figures only relate to the ***average*** taxpayer. Some people pay **much more tax than this**.

But despite this, most of us take no action at all to reduce our tax bill. As a result;

- UK taxpayers are making more than £5.7 billion of ***unnecessary*** tax payments every year - payments that we would not have to make if we spent a little time planning our tax affairs. This is enough to create a new millionaire every day for the next 15 years!

- **9 out of every 10 taxpayers pay too much tax**.

Congratulations! By buying "Cut Your Tax Bill"™ you have taken the first important step in reducing the amount of tax you pay. This book;

- **explains over 300 tax rules, tax loopholes, tax breaks and "secret" tax saving techniques** – it really does tell you what the Inland Revenue would prefer you didn't know!!

- **is a true "Dummies" guide** – it assumes that the reader has no knowledge of tax, so it can be used by everyone

- **is aimed at all UK taxpayers** – no matter what your circumstances, you will find tax help and tax saving tips that are relevant to you

- **is written in simple, plain English** – so that everyone can understand how to save tax

- **is written by experts** – Specialist tax advisers, ex-Inland Revenue and HM Customs & Excise Inspectors, Chartered Tax Advisors and Chartered Accountants are among those who have contributed to this book

- **is unique** – you will not find this advice anywhere else written and presented in this user-friendly way

- **actually works** - all of the tax tips are legal and above board and have been proven to save tax, time and time again. The book consists of a complete collection of the best tax avoidance tips in the UK

A lot of painstaking research has gone into the production of this book. It has taken over 6 months to compile and, because it has been pulled together from such a wide variety of expert sources, we can confidently say that it truly is a definitive collection of the best tax saving advice.

The Guide does not attempt to explain all of the detailed rules and regulations that form the framework of our taxation system, as you do not want to become a tax expert and this would be a very long book! Instead, it explains the areas of our taxation system that you **need** to understand; the parts that will enable you to **reduce the tax that you pay.**

The book lists literally hundreds of tips and suggestions that may save you tax. Some are easy to understand and simple to put into practice; others are more complex and difficult to implement. It is up to you to decide which ones are for you.

However, I must sound **a word of warning** before you start to read the Guide. As a general rule, no tax saving measure should be applied without considering other criteria such as your own personal circumstances and your own financial priorities. Let me take a couple of examples to explain what I mean;

- In Section 4 of this book, we describe how it is possible for a married couple to save tax by transferring investments and savings from the person who has the higher taxable income to the person who has the lower taxable income. Transferring assets in this way enables interest and dividends to be earned by the party that pays tax at the lower rate, thus reducing the family tax bill.

  However, it needs to be remembered that any investments or savings transferred in this way will then legally belong to the recipient. Most couples will continue to enjoy the benefits of reduced tax payments for many years, however others will split up and the assets will then remain with the party that legally owns them. So, whilst most couples will not want to contemplate that their relationship might break down, the prospect of this happening should at least be borne in mind when undertaking any tax-planning exercise;

- A second example can be found in Section 10, which refers to tax-efficient investments.

  In order to benefit from the maximum tax savings, you may need to put your money into an investment for a number of years (which will reduce the amount of money that you have available to spend in the short term), or into investments that carry a higher degree of risk (which may endanger your family's financial security in the future).

You must **<u>always</u>** examine the implications of your proposed tax planning actions from all angles before proceeding. Make your decision about a particular action based on a **full understanding** of the risks, as well as the benefits.

If you are **in any doubt** at all about the steps that you want to take, please consult a tax advisor. Section 23 of the Guide suggests ways in which you can find one.

We have tried to keep the jargon in this Guide to an absolute minimum, but some will inevitably have slipped through the net. If you are faced with words or terms that you do not understand, turn to the Financial Glossary that you received FREE with this tax guide. Dip in and out of this Glossary whenever you need to.

Any Questions?

We regret to say that we do not have sufficient staff to be able to answer tax queries or provide tax advice over the telephone or over the internet – our contact telephone number email address are for orders and sales only.

We have made every effort to ensure that the Guide is self-explanatory and easy to understand but, if you do have a tax-related query arising from something that you have read in this Guide, we recommend that you speak directly with a tax advisor.

Comments and suggestions

You can claim your **FREE "**Guide to Pensions" **<u>and</u>** influence the content of the next edition of "Cut Your Tax Bill" by providing us with feedback on this book and/or suggesting new tax tips.

All you need to do is click on the "About Us" button on our website, then click on "Feedback" and follow the instructions.

We will be delighted to "name check" you in future editions if your suggested tips are published.

Conclusion

You may save tens of thousands of pounds in taxes from reading this book, or you may make a more modest saving, but, whatever the amount, I hope you find it stimulating and enjoyable to read.

Benjamin Franklin once said, ***"..in this world, nothing is certain but death and taxes***". Well, the payment of tax may be certain for most people, but **the amount of tax** that you have to pay is not.

We are confident that by reading this book you will identify many practical ways in which you can reduce the tax that you pay.

Jon Ashcroft
Editor

HOW TO USE THIS GUIDE

Firstly, don't rush!

For ease of reference, the Tips are sorted into Sections. The Sections are defined by the type of taxpayer – "People who are married", "The Elderly", "People on low incomes" etc. - so that you, the reader, can turn quickly to the Tips that are relevant to you.

To help you further, we have provided a shaded "box" at the end of each Tip, which provides;

- A brief **summary** of the Tip,
- A grade for the **maximum tax savings** that could be generated by using the Tip – from "£10,000s" at the top end to "£s" at the bottom,
- A grade for the **complexity** of the Tip and the ease with which it can be put into practice – there are 5 grades, "child's play", "simple", "OK", "difficult" and "complex",
- Suggestions of other matters that you should **consider** if you are thinking about using the Tip; and
- A summary of "**what you need to do**" to put the Tip into practice.

The grades (for "maximum tax savings" and "complexity") are necessarily **very subjective** and are provided *for guidance purposes only*. We advise you not to rely **completely** on these grades when assessing which Tips you will try to implement, as the tax saving that you make, and the ease with which you can put into place a Tip, will be affected by your own personal circumstances and financial knowledge.

We hope this information will help you to make the step from "interested reader" to "tax saver" smoothly and easily.

If you have bought a digital version of this book (either by downloading it from our website, or by buying the CD), we suggest that you **print it out** (or at least those Sections that are relevant to you) and put it into a file or binder for easy reading. You will also find that it is much easier to check back on things that you have not fully understood, and cross-refer between Sections, if you have a printed version.

We suggest that you work slowly and methodically through the Sections that are relevant to you, noting down as you go which Tips might be useful for you. For ease of future reference, you might like to use Appendix 25, the Detailed Contents list, to highlight those Tips that are relevant to you. A separate column is provided in Appendix 25 for this purpose.

Once you have finished, you should re-read all of the Tips that you have noted as being relevant to you. *Note: You will probably find that some Tips cover the same underlying problem. Where this is the case, you will not need to implement them all – you will just need to choose one.*

You should then make a list of the Tips that you want to implement, in an order of priority. In doing this, you should bear in mind;

- how much tax you think you will save,
- how easily you can put the Tip into effect,
- that there is no need to implement two Tips if they address the same problem,
- your personal circumstances,
- your financial priorities.

OK, now you can start to save money - but **don't try and do everything at once**! Instead, look to make steady progress, by working from the top of the list, implementing the highest priority Tips first.

Whatever you do, don’t end up doing nothing in a particular area because you can’t work out precisely which is the best Tip for you. If you really can’t decide which Tip is best, use more than one and see how they work!

Dip in and out of the Guide every six months or so, or every time that your financial circumstances change, and revise your list.

Finally, you **<u>must</u> keep up to date** with changes in the tax rules and regulations. Only by doing so, will you continue to save tax in the future.

1 CONTENTS

For ease of reference, this Guide is divided into sections. You should read those that are labelled "for all" and any others that are relevant to you, or your family;

A number of Appendices and Bonus items are also included in this Guide;

Appendices	Number
Inland Revenue **Helpline Numbers**	1
Trusts	2
Flat rate deductions	3
Capital allowances	4
Tax deductible business costs	5
Indexation allowance	6
Rules of intestacy	7
Bonus Items	**Number**
Inheritance Tax Planning Checklist	1
Statement Of Assets and Liabilities	2
Self Assessment Calendar	3
Guide to **Tax Credits**	4
Standard Letters	5
Tax **Allowances**	6
Glossary of Financial Terms	7

2 TAX BASICS

Before we start providing you with Tax Tips, we need to "set the scene" and explain some basic information about the current UK tax system.

In this Section, you will learn;

- **about "tax years" and why they are so important**
- **about Self Assessment, and whether it applies to you**
- **how income tax is calculated**
- **what tax allowances you can claim**
- **which of the various types of national insurance contributions apply to you and how they are calculated**

2.1 Tax Year

For historical reasons that we really don't want to bore you with, the tax year runs from 6th April one year to 5th April the following year. The tax year that runs from 6th April 2006 to 5th April 2007 is referred to as the "2006/07 tax year" (or, more succinctly, just "2006/07").

A tax year is important because;

- **tax rates and tax allowances are set for each tax year,**
- **your tax bill is calculated based on your taxable income for each tax year,**
- **the date(s) when you must pay your tax is determined by your taxable income for each tax year.**

2.2 Income Tax

There are many taxes in the UK, but the most important tax for the average person is income tax. Let us start here.

You pay income tax on your income. Your "income" includes;

- your earnings **from your employment** (as an employee of as a self-employed person)[1],
- interest and dividend income **from investments and savings**, and
- income **from pensions**.

DEFINITION

It is important that you understand what we mean by "income", and how this is different from "capital gains".

<u>Capital gains</u> *arise from an increase in the* ***price*** *(**or** **<u>value</u>**) of an asset (for example in the price of a share or in the value of a house).*

<u>Income</u> *arises from payments that are made to you because you* ***own*** *an asset (such as dividends on a share or interest on a bank account) or because you do something (such as your salary from work).*

[1] Including fringe benefits. See 7.7.

2.3 Self Assessment

Self Assessment is the process by which a person reports his or her income for a tax year on a Tax Return.

In 2004/05 over 10 million people were asked to complete a Tax Return.

In general terms, you will need to complete a Tax Return if you fall into **any one** of the following 7 categories;

- You are **self-employed**;
- You are a **company director**;
- You are **in partnership**;
- You are an **employee with** more **complicated tax affairs** (e.g. an employee who has a company car);
- You are an **employee who receives income in addition to salary** – e.g. if you are a freelance consultant;
- You are a **higher rate taxpayer with savings or investment income**;
- You are a taxpayer and **you receive untaxed income**.

It is **your** responsibility to ask for a Tax Return if you fall into one of these categories. It is not a defence to say that "I didn't complete a Return because I wasn't sent one!"

An employee who pays tax through the "Pay As You Earn" system ("PAYE"), and who does not fall within any of the previous categories, will not need to complete a Tax Return. The PAYE system allows an employer to deduct tax from your wages or salary.

Everyone who completes a Tax Return **must** fill in the main eight-page Tax Return, which covers:

- Income from savings and investments
- Pensions
- Tax allowances and tax reliefs
- State benefits
- Maintenance payments

In addition, a taxpayer is also required to fill in any relevant "Supplementary Pages", which cover other types of income and profits. Supplementary Pages exist for;

- Employment
- Share schemes
- Self-employment
- Partnership
- Land and property
- Foreign income, gains and tax credit relief

- Trusts, settlements and the estates of deceased person
- Capital Gains
- Non-residence

If you are in any doubt about the Supplementary Pages that you need to complete, you should call your Tax Office (see 2.14. below) and ask for advice. If you need to order some Supplementary Pages because they were not sent to you with your Tax Return, you should call the Inland Revenue orderline on 0845 9000 404, which is open from 8am to 10pm, 7 days a week, and they will send them to you.

If you have to complete a Tax Return, you can choose to return it by;

- **30th September** after the end of the tax year, in which case the Inland Revenue will calculate your tax bill for you, or
- at latest, **31st January** after the end of the tax year, in which case you will have to calculate the tax bill yourself.

ILLUSTRATION

For the 2005/06 tax year, you will need to submit your Return by 30th September 2006 if you want the Revenue to calculate your tax bill or, failing this, by 31st January 2007 and you will have to calculate the tax yourself.

2.4 Tax Allowances

There are two basic points that you need to understand about allowances;

- They reduce the income on which you pay tax; and
- They are given for each tax year.

Tax allowances are set by the Government, normally in the Annual Budget.

The various tax allowances for the tax years 2005/06 and 2006/07 are shown in Figure 1 below;

Figure 1: Tax Allowances 2005/06 and 2006/07

Allowance	2005/06 (£)	2006/07 (£)
Personal allowance;		
For those aged under 65	4,895	5,035
For those aged 65-74	7,090	7,280
For those aged 75 and over	7,220	7,420
Married Couples allowance;		
Born before 6 April 1935 and aged less than 75	5,905	6,065
Aged 75 and over	5,975	6,135
Minimum amount	2,280	2,350
Relief for Blind Person (each)	1,610	1,660

The **Personal Allowance** is given to every man, woman and child, single or married, who is resident in the UK.

As Figure 1 shows, the amount of your Personal Allowance depends on your age. The higher Personal Allowances are given to you if you reach the appropriate age **at any time in the tax year**.

The **Married Couples allowance** is explained in Section 4.

2.5. Tax Deductible Costs

Tax Deductible Costs (or "Allowable expenses") are deducted from your "income" before you calculate how much tax you have to pay. Like Tax Allowances, these items therefore reduce the tax that you have to pay on your income for the tax year.

The costs that ***you*** can treat as "tax deductible" will depend upon your circumstances. This is discussed later in this Guide.

2.6 Taxable income

In very simplistic terms;

- your income less your Tax Allowances and less your Tax Deductible Costs is your "taxable income"; and
- your tax bill for a tax year is calculated based on your "taxable income" for that year.

EXAMPLE

Ken Blecher, a single man, earns a salary of £38,150 in 2005/06. He has no Tax Deductible Costs for 2005/06.

Ken is entitled to claim a personal tax allowance of £4,895, which leaves him with taxable income of £33,255 for 2005/06.

2.7 Income Tax Rates

Income Tax Rates are set by the Government. They determine how much tax you pay on your taxable income.

Figure 2 below sets out the rates that apply for 2005/06, and the "bands of income" to which they apply.

Figure 2: Income Tax Rates 2005/06

Taxable Income (£)	Rate of Tax	Tax on Band (£)
0 to 2,090	10%	209.00
2,090 to 32,400	22%	6,877.20
Over 32,400	40%	

As Figure 2 shows, there are three rates of income tax that currently apply in the UK;

- The first rate of tax of 10% (called **the starting rate**) is applied to the first £2,090 of taxable income,
- The second rate of tax of 22% (called **the basic rate**) is applied to any taxable income over £2,090 and less than £32,400,
- The third rate of tax of 40% (called **the higher rate**) is applied to all taxable income over £32,400. The amount at which the higher rate is applied (being £32,400 for 2005/06) is often called the "higher rate threshold".

People are often referred to as "higher rate taxpayers" or "basic rate taxpayers". What does this mean?

- A "higher rate taxpayer" is a person whose taxable income for the tax year is more than the "higher rate threshold". The term is used to indicate that some of the taxpayer's income is taxed at the higher rate.

- A “basic rate taxpayer” is a person whose taxable income for the tax year is lower than the “higher rate threshold”, but is more than the “basic rate threshold” (£2,090 for 2005/06). The term is often used to indicate that the taxpayer is not a higher rate taxpayer.

EXAMPLE

Following on from the previous example above, Ken would pay income tax of £7,007.60 for 2005/06, calculated as follows;

Ken’s Taxable Income (£)	***Rate of Tax (%)***	***Tax on Band (£)***
0 to 2,090	*10%*	*209.00*
2,090 to 32,400	*22%*	*6,877.20*
32,400 to 33,255	*40%*	*342.00*
Total		***7,428.20***

As some of Ken’s taxable income is taxed at the higher rate, Ken is a “higher rate taxpayer”.

2.8 Income from savings and investments

The calculation of tax gets more complicated if your taxable income includes income from savings and/or income from investments (namely interest and/or dividends).

This is for two reasons;

Firstly, **different income tax rates apply to this income**.

Figure 3 below shows the tax rates that apply to income from savings and investments, compared to other income (which will mainly comprise of earnings from your employment). These rates have applied for a number of years and continue to apply for 2005/06 and 206/07.

Figure 3: Rates of tax for each type of income

	Income from savings (interest)	**Income from investments (dividends)**	**Other income**
Starting rate	10%	0%	10%
Basic rate	20%	10%	22%
Higher rate	40%	32.5%	40%

And secondly, you will normally receive interest and dividend income **net of tax**. This means that tax **at the basic rate** will have been deducted from the income that you receive.

ILLUSTRATION

David Clarke has a deposit account at HSBC and in 2005/06 his account was credited with interest totalling £1,500.

David also owns a variety of UK shares on which he received £7,920 of dividend income during 2005/06.

David’s gross interest income would have been £1,875, but the bank will have deducted 20% basic rate tax (of £375) before crediting his account. Thus;

Gross interest	*1,875*
Less; Tax of 20%	*(375)*

Net interest credited to account	*<u>1,500</u>*

The gross value of David's dividends would have been £8,800, but the companies that declared the dividends will have deducted tax at the basic rate of 10% before paying the dividends to David.

Thus;

Gross dividends	*8,800*
Tax deducted at source;	
10% x 8,800 = 880	*(880)*
Dividends received by David	*7,920*

DEFINITION

*"Gross" is a term that is applied to income to indicate that **no tax** has been deducted.*

*"Net" is a term that is applied to income to indicate that tax **has already been** deducted.*

2.9 Calculation of Tax Payable

The Inland Revenue specifies the order in which income must be brought into your tax payable calculation. This order is as follows;

- Firstly, income other than savings income and dividend income;
- Secondly, savings income; and
- Thirdly, dividend income

An example showing how this is done is included at the end of this Section (see 2.16). The calculation is quite complicated, so, if you are a tax novice, you may like to skip over this example for the time being.

It is worth noting three important points at this stage;

- You will **not** pay any further tax on interest or dividend income (over and above what has already been "deducted at source") **if** your total taxable income is less than the threshold for the higher rate tax band (£32,400 for 2005/06);
- If you receive interest income **and** your taxable income is below £2,090 (the threshold for the basic rate tax band), you will be able to **reclaim** some of the tax that has been deducted at source; and
- The rules state that the tax deducted at source on dividend income **cannot be reclaimed** under any circumstances. Even if your taxable income is below £2,090, you are not allowed to get a refund of the tax deducted at source on dividends.

2.10 New Income Tax Bands

The income tax bands have been increased slightly for the tax year 2006/07, as shown in Figure 4 below;

Figure 4: Income Tax Rates – 2006/07

Band of Taxable Income (£)	Rate of Tax	Tax on Band (£)
0 to 2,150	10%	215.00
2,150 to 33,300	22%	7,068.00
Over 33,300	40%	

The tax rates that apply to income from savings and investments (see Figure 3 above) are unchanged.

2.11 Changes to Income Tax Bands and Allowances

The income tax bands and tax allowances are normally increased each year in line with the increase in the Retail Prices Index during the year to the end of September prior to the start of the tax year in question.

Thus, the allowances and bands for 2006/07 were calculated by taking the figures for 2005/06 and increasing them by the increase in the RPI for the year ended 30th September 2005.

2.12 National Insurance Contributions

It is worth mentioning National Insurance Contributions at this stage as, in many ways, they represent another form of income tax.

You will **pay** National Insurance contributions on;

- Earnings from your employment; and

- Profits from your self-employment

In this respect, the basis of charge is similar to that of income tax.

However, you will **not pay** National Insurance contributions (NICs) on any savings income (interest, dividends) or on any pension income - this is a key difference between how income tax is charged and how NICs are charged.

There are several different types of NIC (all figures quoted for 2005/06);

- **Class 1**: Paid if you are an **employee** on your **earnings** at a rate of 11% of earnings between £94 per week and £630 per week (or 9.4% if you are a member of an occupational pension scheme and are contracted out of the State Second Pension) and 1% on earnings above £630 per week. Class 1 NICs are also paid by **employers** at a rate of 12.8% on the **earnings of each of their employees** above £94 per week.

- **Class 1A**: Paid by **employers** at a rate of 12.8% on **fringe benefits** (or "taxable benefits") given to employees (note that employees **do not** pay Class 1A NICs).

- **Class 2**: Paid if you are **self-employed** at a **flat rate** of £2.10 per week on earnings above £4,345.

- **Class 3**: Paid voluntarily to build up an entitlement to social security benefits at a rate of £7.35 per week.

- **Class 4:** Paid if you are **self-employed** at a rate of 8% on your **business profits** between £4,895 and £32,760 and 1% on your **business profits** above £32,760.

The minimum level of income that you have to earn before you are required to pay NICs is therefore as follows;

- **Class 1** and **Class 4** - £4,895

- **Class 2** - £4,345.

2.13 State Benefits

Certain state benefits, such as jobseekers allowance, are **taxable** and need to be reported under Question 11 of your tax return. Here is a full list;

- Incapacity Benefit paid on new or revised claims (from April 1995) at the higher short-term rate and long-term rate,
- Invalid Care Allowance,

- Statutory Sick Pay and statutory Maternity Pay,
- Employer's contribution to sick pay paid out of an employer's sick pay scheme,
- Retirement Pension, including any invalidity addition,
- Widow's Pension, Widow's allowance and Widowed Mother's Allowance,
- Unemployment Benefit,
- Income Support paid to those who are unemployed, on strike, or involved in a trade dispute,
- Jobseeker's Allowance,
- Industrial Death Benefit (if paid as a pension)

At the end of each tax year, the Department of Work and Pensions (DWP) will issue you with a form P60U that shows the income that they have paid you in the tax year that needs to be reported on your tax return.

2.14 Your Tax Office

If you are employed, your Tax Office will generally be that of your employer. Your employer's personnel department will be able to provide you with an address and a contact telephone number for this Tax Office.

If you are self-employed, your Tax Office will generally be determined by where you live.

If you already receive a Tax Return, your Tax Office will be given at the top of your Tax Return.

If you do not already receive a Tax Return, you can find the telephone number for your local Tax Office by looking in the Business Section of your local phone book under "Inland Revenue".

2.15 Getting assistance

If you need help about something specific to you, you should contact **your** Tax Office.

For general enquiries, you can contact any Tax Office or Inland Revenue enquiry centre (you will find them in your phone book).

You can ask the Tax Office to call you back, to save on phone bills.

There are a number of Revenue helplines, dealing with specialist subjects. These are listed in Appendix 1.

The Revenue also produces a large number of information leaflets, and these are listed on the Revenue's website – www.inlandrevenue.gov.uk.

WARNING: Do not read 2.16 below if you are new to tax – not yet anyway!

2.16 Example illustrating the tax calculation for someone with interest and dividend income

We include an example below to show how tax is calculated for someone who receives interest and dividend income. It illustrates the rules described in 2.9 above.

If you are new to tax, we suggest that you skip over this example for the time being – as it is quite complicated and it may scare you off reading the rest of the book! By all means return to it when you have read the book once, if you feel that you need to.

EXAMPLE

Kate Ingles earned a salary of £31,130 in 2005/06 and she was entitled to claim a personal allowance of £4,895. In addition, she received bank interest of £6,000 and dividend income of £2,475.

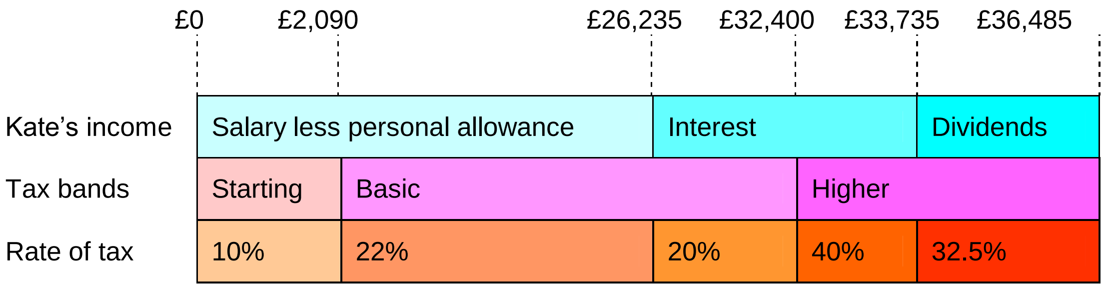
Kate's bank interest and dividend income will have had tax deducted at source.

Her gross bank interest (i.e. before any deduction of tax at source) was £7,500 (£7,500 less 20% tax deducted at source = £6,000) and her gross dividend income was £2,750 (£2,750 less 10% tax deducted at source = £2,475).

Kate's income needs to be taxed in the order of

- income other than savings and dividends;
- savings income;
- dividend income.

The graphic below shows how this is done.



This graphic shows 3 lines;

- The top line is Kate's income, listed in the order prescribed by the rules – firstly income other than savings and investment income (i.e. salary), secondly, savings income (interest) and lastly investment income (dividends). You will notice that Kate's Personal Allowance has been deducted from her salary in arriving at the amount of salary that is to be taxed,

- The second line shows the income tax bands for 2005/06, and

- The third line shows what rates of tax apply to Kate's income (based on the interaction of the income tax bands (line 2) and Kate's income (line 1)

And so;

- *Kate's salary less her personal allowance (of £26,235) is taxed partly at the starting rate of 10% (up to £2,090) and partly at the basic rate of 22% (£24,145);*

- *Kate's interest income (of £7,500) is taxed partly at the basic rate of 20% (£6,165) and partly at the higher rate of 40% (£1,335);*

- *Kate's dividend income of £2,750 is taxed wholly at the higher rate of 32.5%.*

Kate's tax charge is therefore calculated as follows;

On the first £2,090 @ 10%	*209.00*
On the next £24,145 @ 22%	*5,311.90*
On £6,165 of her interest income @ 20%	*1,233.00*
On £1,335 of her interest income @ 40%	*534.00*
On her dividend income of £2,750 @ 32.5%	*893.75*
Total tax payable	***8,181.65***

When calculating what tax Kate is due to pay to the Inland Revenue for 2005/06, she will deduct from this total tax payable of £8,181.65;

- any tax that she has paid by deduction from her salary;

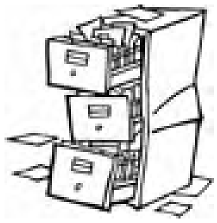
- the tax deducted at source from her interest income (i.e. £1,500), and

- the tax credits on the dividends that she received (i.e. £275).

3 GET ORGANISED

Before turning to the Tax saving Tips, there are two **fundamenta**l points that we need you to understand.

3.1 Keep Proper Records



Firstly, there are records and documents that you **must** keep.

- Some of these items are needed so that you can **minimise** the tax that you pay – and these items are referred to throughout the rest of this Guide;
- Other items are needed to help you **complete your Tax Return**. These items are listed below.

If you are **employed**, you should keep;

- Form P60, which your employer will give you after 5th April and which summarises your pay and tax for the tax year
- Form P45, which an ex-employer will give you when you leave a job, showing your pay and tax in that job during the tax year
- Your payslips
- A record of all tips and gratuities not recorded on your payslips
- Form P11D, or P9D, from your employer, setting out the fringe benefits (or benefits in kind) and expenses payments given to you during the tax year

If you are receiving **a pension or benefits**, you should keep;

- Form P160, from the payer of your occupational pension, setting out your pension and tax for the tax year
- Any other certificates setting out the pension you have received and any tax that has been deducted
- Information from the Department for Work and Pensions relating to state pensions and taxable state benefits that you have received during the tax year

If you are **self-employed**, you should keep;

- Invoices and receipts for all sales and purchases
- Bank statements, paying-in slips and cheque stubs
- A "cash book", detailing and analysing all receipts into, and payments from, your business bank account during the year
- A petty cash book to record all cash transactions
- Copies of VAT returns (if applicable)

If you receive **investment income**, you should keep;

- Bank and building society statements
- Statements of interest and any other income received

- Tax deduction certificates
- Dividend vouchers
- Unit trust tax vouchers
- Life insurance chargeable event certificates

If you have made **capital gains and losses**, you should keep;

- Documents that support the purchase cost and sales price of assets, as well as any cost incurred in improving an asset (including contracts, invoices, bank statements and receipts)
- Copies of any relevant asset valuations

If you are **claiming allowances, deductions and reliefs**, you should keep;

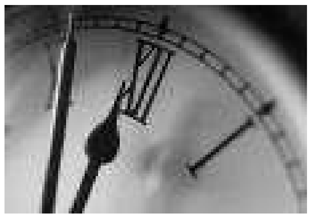
- Marriage certificate
- Birth certificate
- Personal pension plan and self-employed premium certificates
- Gift Aid declarations
- Court orders and maintenance agreements
- Certificates of interest paid

This list is not complete and does not cover all situations.

If you are in any doubt at all about what you need to keep, ask your local Tax Office or Tax Enquiry Centre for advice.

You must get into the habit of filing important information in a safe place when you receive it.

3.2 Plan Your Affairs



The second fundamental point is that you must **make time** to **plan your tax affairs**.

You will **not** minimise your tax payments if you only think about tax once a year as you are rushing to complete your Tax Return.

You have to set a little time aside regularly, maybe a couple of hours every 3 months or so, to make sure that you are doing all that you can to reduce your tax bill.

During this time, you should;

- Write down what changes there have been **in your financial circumstances** since you last did some tax planning – maybe you have a higher paid job, or you have sold some shares;
- Write down what changes there have been **in your personal circumstances** since you last did some tax planning – maybe you have got married or divorced;
- Have a browse through this Guide, to see if there are any **specific tax planning points** that are relevant to your changes in circumstances;
- Decide what **actions** you need to take, if any, to reduce your tax bill, and when you need to take them;
- Decide if you need to take any **advice** from a tax advisor or Independent Financial Advisor before acting.

Over the course of a year, you should expect to spend **at least** 6 to 8 hours planning your tax affairs.

Whilst spending regular time on tax planning is a minor irritation, **the potential rewards are huge**.

Even if you only manage to achieve a relatively modest tax saving of £1,000, and you spend 10 hours over the course of the year on tax planning, you will effectively have been rewarded for your time at the rate of £100 per hour!

This, then, is the first important decision that you need to make. Can you commit this amount of time to tax planning? If not, you should **<u>stop reading now</u>**. Close the book, put it on the shelf and go and do something else.

Remember, you will only maximise your tax savings by taking time to plan your tax affairs **<u>throughout</u>** the year.

A lack of organisation and planning is the single biggest reason why people pay too much tax.

OK. Now we can turn to our specific Tax Saving Tips.

4 PEOPLE WHO ARE MARRIED

You should read this Section if you are married.

In this Section, you will learn why you should give careful consideration to the ownership of your savings and investments.

4.1 Transfer savings and investments between spouses

If you pay tax at a higher rate than your spouse, you can save tax by transferring savings and/or investments to your spouse.

Any income received from these savings and investments will then be taxed at a lower rate.

EXAMPLE

David Coombs is a higher rate taxpayer. His salary in 2005/06 was £60,000.

David has a deposit account on which he received interest of £2,000 in 2005/06 (gross interest therefore £2,500) and a savings account on which he received interest of £1,500 (gross = £1,875).

His wife, Kate, does not work and has no other income.

David will pay tax at a rate of 40% on the gross interest of £4,375 that he earns in 2005/06, amounting to £1,750. £875 of this tax (20%) will have been deducted at source, leaving David to pay a further £875.

By transferring the deposit account and savings account into his wife's ownership, the total interest income of £4,375 would all be earned free of tax (as his wife has a personal allowance of £4,895 for 2005/06 which is more than enough to cover the interest income). Her taxable income would be nil.

David's wife will not pay tax and she will also be able to reclaim the tax deducted at source.

By transferring his deposit and savings accounts to his wife, David and his wife will save tax of £1,750.

This is easily done and large tax savings can be achieved.

The key point is that your spouse **must be paying tax at a lower rate than you** for tax to be saved.

There **must** be an actual, legal, transfer of the asset(s) from one spouse to the other. For example, in the case of bank accounts, the name of the account holder must be changed, and in the case of shares, the name of the shareholder must be changed.

If you do not feel comfortable transferring the full amount of the asset to your spouse, you could always transfer part of the asset or put it into joint names. In this situation, the income generated by the asset would be shared between each party for tax purposes.

There are no other tax implications of transferring assets between spouses, as such transfers can be done without creating any liability to Capital Gains Tax (see Section 19) or Inheritance Tax (see Section 20).

TIP	Reduce the tax that you pay on your savings and investment income by transferring assets to your spouse if he/she pays a lower rate of tax than yourself.		
SAVE	£100s	**EASE OF USE**	Simple
What You Need To Do	Estimate the total annual taxable income for each spouse By comparing these incomes with the tax bands, determine whether one spouse is paying tax at a higher rate than the other If one spouse is paying tax at a higher rate, estimate how much income this spouse is earning income from interest and dividends ("savings and investment income") Calculate how much of this income needs to be transferred from the higher rate taxpayer to the lower rate taxpayer to "equalise" their tax rates (to make each taxpayer pay tax at the same rate) Decide if the spouse is willing to transfer assets to the other spouse which generate this level of income Legally transfer the assets		

4.2 Other relevant Tips elsewhere in this Guide;

- Married Couples Tax Allowance (see 6.2)
- Pay Your Spouse (see 8.14)
- Pay Your Spouse (see 9.3.3)
- Maximise Your Tax benefit from donating to Charity (see 12.4)
- Transfer Assets to your spouse (see 19.2)
- Joint ownership (see 19.3)
- Equalise your estates (see 20.9)

5 PEOPLE WITH CHILDREN

You should read this Section if you have children.

In this Section you will learn;

- **About Tax Credits and whether you are entitled to them**
- **How your child can receive income on savings and investments without paying tax**
- **Why you should be very careful about how you give money or assets to your child**
- **Why you should not buy accommodation for your child in your own name**
- **About the Child Trust Fund which was introduced in April 2005**

5.1 Claim Child Tax Credit

Broadly speaking, anyone who earns less than £58,175 in 2005/06 and who has dependent children (or £66,000 if you have a child under 12 months old during the tax year) is entitled to receive Child Tax Credit.

People on low incomes will receive significant sums of money from this Credit. Even those people right at the top end of the income limit will receive £545 a year.

You have to make a claim to receive this Credit. It is **not paid automatically**.

Furthermore, claims can only be backdated for a maximum of 3 months. **Therefore a claim for Child Tax Credit for 2006/07 must be made by 5 July 2006**. Claims can be made after this date but, if you do, you will not receive a full year's tax credit.

The calculation of the Child Tax Credit is explained in the "Guide to Tax Credits" which is one of the 6 FREE reports and publications that you have been given with "Cut Your Tax Bill"™.

It has been reported that there are over **700,000 people** in the UK **who are not claiming the Child Tax Credit** that they are entitled to. Don't be one of them.

TIP	Claim your entitlement to Child Tax Credit		
RECEIVE	£1,000s	**EASE OF USE**	OK
CONSIDER	Working Tax Credit – see below		
What You Need To Do	Read the "Guide to Tax Credits" and decide whether you can benefit from Child Tax Credit. If you are unsure, you can check your entitlement to Tax Credit by completing the online questionnaire that you will find by logging on to the Inland Revenue website and following the links to "Tax Credits/Do I Qualify", or by typing the following link into your web browser; "https://www.taxcredits.inlandrevenue.gov.uk" Call the Tax Credit helpline on 0800 500 222 to obtain the necessary Claim Form Complete and send back the Form		

5.2 Claim Working Tax Credit

Working Tax Credit ("WTC") can be claimed by anyone who is working (either employed or self-employed) and who;

- usually undertakes paid work for at least 16 hours a week, **and** is aged 16 and over **and** is either responsible for at least one child or is disabled,

  or

- usually works for at least 30 hours a week, **and** is over 24 **and** has no children.

As you can see, this last condition allows people to claim Working Tax Credit ***who do not have children.*** This is contrary to what most people think.

The amount of WTC that you will be awarded is dependent on several factors, including your annual income and some of your personal circumstances, such as;

- whether you are a lone parent or not,
- how many hours a week you work, and
- what, if any, childcare costs you incur.

How you receive your tax credits depends on whether you are employed or self-employed;

- The **self-employed** receive WTC direct from the Inland Revenue.
- **Employees** receive WTC from their employers, apart from any childcare element – see below.
- The childcare element of the WTC is paid with any Child Tax Credit, direct to the individual, **whether the individual is employed or self-employed**.

As with Child Tax Credit, you have to make a claim to receive WTC - it is **not** paid automatically – and claims can only be backdated for a maximum of 3 months.

The calculation of WTC is explained in the "Guide to Tax Credits".

TIP	Claim Working Tax Credit		
SAVE	£100s	**EASE OF USE**	OK
CONSIDER	Child Tax Credit – see before		
What You Need To Do	Read the "Guide to Tax Credits" and decide whether you can benefit from Working Tax Credit If you are unsure, you can check your entitlement to Tax Credit by completing the online questionnaire that you will find by logging on to the Inland Revenue website and following the links to "Tax Credits/Do I Qualify", or by typing the following link into your web browser; "https://www.taxcredits.inlandrevenue.gov.uk" Call the Tax Credit helpline on 0800 500 222 to obtain the necessary Form Complete and send back the Form		

5.3 Increase your tax credits

As we have already described, the amount of Tax Credits that you will receive is determined partly by your income in a tax year.

The basic principle is;

the lower your income, the higher your tax credits

Your "income" for the purposes of calculating your entitlement to Tax Credits is broadly the same as your taxable income (as explained in 2.6), although it does **not** include;

- some fringe benefits that you receive,
- the first £300 of any income that you receive from investments, property and foreign sources.

This means that any pension contributions that you make are deducted in arriving at this "income".

Because of this, you can reduce your "income", and therefore **increase your tax credits**, by making pension contributions.

However, the bad news is that this will **not** leave you with more money in your pocket, as the extra amount that you receive in tax credits will not be as great as the money that you "spend" on pension contributions.

The good news is that the government will effectively be subsidising any extra pension contributions that you make **in two ways;**

- through the increase in your tax credits (as discussed above), and
- from the tax relief that you get on the contributions themselves (this is explained in Section 18).

Because of this, you might only have to meet **40%** of the cost of the contributions yourself! This makes this is a very tax efficient means of putting money aside for your future.

TIP	Increase tax credits by making a pension contribution		
RECEIVE	£100's	**EASE OF USE**	Simple
CONSIDER	Whilst this will save you tax, it will also leave you with less money in your pocket, as the tax saving (plus the amount that you contribute) is invested in your pension plan.		

5.4 Receive Interest Income Gross

All children, regardless of their age, are entitled to their own Personal Allowance (as described in 2.4). This means that every child can earn up to £4,895 of income in 2005/06 (£5,035 for 06/07) without paying tax.

If a child has a bank or building society account, he or she will receive interest net of tax, i.e. the bank or building society will deduct tax of 20% before crediting his/her account.

If your child's income in the tax year is less than the Personal Allowance, you should register to have the interest paid gross. This means that the bank or building society will not deduct income tax from the interest before it is paid to the child.

All you need to do it ask your bank or building society for the standard Inland Revenue Form R85, which you will need to complete and return to the bank or building society.

You can register more than one account with the same bank or building society on one form, but you will need to complete a separate form for each different bank or building society that your child receives interest from.

The form is simple to complete (requiring only the most basic of details about your child – address, national insurance number and date of birth – and the account(s) itself – account number, bank/building society name and branch name).

TIP	Register for your child's interest income to be paid gross		
SAVE	£100s	**EASE OF USE**	Child's Play
CONSIDER	Previous year's tax claims (see below)		
What you need to do	Ask each bank or building society at which your child has an account for a Form R85 Complete the Form and return it to the Bank or Building Society		

5.4.1 Claim a refund of tax deducted in previous years

If your child has received **net** interest in previous years and he/she has **not reclaimed** the tax that has been deducted at source in those years, your child will be entitled to a **tax refund**.

You can claim a tax refund for tax overpaid by your child over the last 6 tax years.

All you need to do is write to your local Tax Office, providing the basic details about your child that are required by the Form R85 (see above), along with the bank account statements (or other documents) which show how much tax has been deducted in the past, and the Revenue will provide your child with a tax refund.

If you have not kept copies of the statements, you can ask your bank or building society for them.

TIP	Make a claim for a tax refund if your child has received interest net of tax in previous years		
SAVE	£100s	**EASE OF USE**	Simple
What you need to do	Get documentation which proves how much tax your child has paid in previous tax years (statements, interest certificates etc). Write to your local Tax Office, enclosing this documentation, and providing your child's full name, address and national insurance number. You should itemise the amounts of tax that have been deducted from your child's interest and total up these amounts for each tax year. You should state that your child received no other income in these tax years (or set out what other income was received). And finally, you should state that you would like to claim a tax refund on behalf of your child for the tax that he/she has paid.		

5.5 Buying accommodation for a child

It is becoming increasingly common for parents to buy accommodation for their children to stay in whilst they are at university or undertaking some other form of Further Education. In these situations it is possible that income will be received by renting rooms out to other students.

If you buy accommodation in your name, you will have to notify the Inland Revenue of the rental income, and **<u>you</u> will be taxed on this income**. If you then sell the property after your child has finished their studies, **<u>you</u> will be liable to pay Capital Gains Tax** on the increase in the value of the property.

However, if things are arranged so that it is actually **the child's property** – maybe it is purchased with you (or your spouse) acting as the guarantor for the mortgage – then;

- Your child should be able to take advantage of the "rent a room" rules for letting part of their home (see 9.3.10). This means that they would receive £4,250 of rent tax-free in 2005/06 and 2006/07,

- Your child would also receive their normal Personal Allowance, which is £4,895 in 2005/06 (£5,035 in 2006/07), and

- Your child would be able to claim exemption from capital gains tax when the property is sold (as the property would be his/her "main residence" – see Section 19).

Under this arrangement, your child would have to receive more than £9,145 of income in 2005/06 (and £9,285 in 2006/07) before he/she would pay tax (as this is the total value of the tax allowances), and there would be no Capital Gains Tax to pay when the accommodation was sold.

EXAMPLE:

David Rastall, who is a higher rate taxpayer, bought a two-bedroomed house in Durham for his daughter Vicky when she went to University in 2002. The house cost £60,000.

Vicky rented out the spare bedroom for £80 a week to one of her course mates. When Vicky finished university in June 2005, the house was sold for £85,000.

David received £7,200 of rental income over the 3 years, on which he paid (or he will be due to pay) £2,880 of tax (at a rate of 40%). David's annual CGT allowance in 2005/06 is £8,500. Assuming that he has no capital losses to offset against the capital gain on the sale of the house, his chargeable gain is £16,500[2]*. David's tax bill on the sale (at a rate of 40%) is therefore £6,600.*

David will therefore have paid nearly £10,000 in tax over this 3-year period. Had the house been put into the name of his daughter, the gain on the sale of the house would not be taxable and the annual "rent a room " allowance would have more than offset the rent received. ***As a result, no tax would have been paid - a saving of nearly £10,000.***

TIP	If you are buying accommodation for a child, there may be significant tax advantages to buying the accommodation in their name		
SAVE	£10,000s	**EASE OF USE**	Simple
What you need to do	Talk to a mortgage broker or mortgage company after you have found the accommodation that you want to buy, and tell them that you want the property to be in your child's name and that you will act as guarantor for your child's mortgage. Tell the conveyancing solicitor that the house will be in your child's name.		

5.6 Transferring income to your child

We have already explained that all children, regardless of age, are entitled to their own Personal Allowance.

Any income of the child below the Personal Allowance (£5,035 for 06/07, £4,895 for 05/06) is effectively received tax-free.

If you have a child who has "surplus Personal Allowance" (i.e. their current income is less than their Personal Allowance), then you can save tax by transferring some of your income to that child to use up this "surplus". This can be done by transferring the ownership of assets which generate income - such as cash (which generates interest) and investments (which generates dividends) – from you to your child.

This arrangement would save the amount of tax that you would pay on the income if it remained yours.

However, (yes, there had to be a "but", didn't there?), there are rules in place to stop parents transferring their own assets to their children to avoid paying tax.

The rules state that;

[2] For simplification purposes, this ignores taper relief (see Section 19) and any costs incurred in buying and selling the house. It is calculated as the gain on the sale of the house (£85,000 less £60,000) less David's annual CGT allowance (£8,500 for 2005/06).

- If you give your child an asset or assets that produce **less** than £100 of taxable income[3] per year, then that income will be treated as your *child's* and taxed as their income. If the total of their taxable income is less than their personal allowance, they will therefore not pay any tax on this income. **However**,

- If you give your child an asset or assets that produce **more** than £100 of taxable income per year, **all** of that income will be still be treated as ***yours*** and will continue to be taxed as part of your income.

Important notes.

- If the taxable income exceeds £100, **all** of the income is taxed as the parent's income, **not just the amount over £100.**

- The limit of £100 applies to **all** gifts given by the parent to the child in the current tax year **and all previous tax years**.

- The limit applies to each parent separately, so in theory two parents could give each of their children assets that generate up to £200 of income a year without breaching these rules.

- This also applies to income earned on assets that you have transferred to an Accumulation and Maintenance Trust where your child is a beneficiary of the Trust and the income is paid out to, or for the benefit of, the child. Trusts are described in Appendix 2 and various tax saving Tips that relate to Trusts are described throughout this book.

Care clearly needs to be taken so that each parent does not give assets that produce more than £100 of income a year per child, but there is still room for a little tax planning in this area - especially if you have a number of children!

ILLUSTRATION

Alice Podd is a single mum and a basic rate taxpayer. She has one child, Paula, who is aged 5. Alice earns £2,500 a year in gross interest from a nest egg left to her by her late father. Alice currently pays tax of £500 on this interest (at a rate of 20%).

Paula earns £1,100 in income from a unit trust investment left to her by her Grandfather when he died.

Paula therefore has a "surplus personal allowance" of £3,795 for 2005/06 (being £4,895 less £1,100).

If Alice transferred the ownership of the entire nest egg to Paula, she would effectively be giving her £2,500 of taxable income. As such, this would breach the "£100 rule" described above, and Alice would be required to pay tax on all of the interest that Alice receives. There would no tax saving.

Alice could only give Paula a very small proportion of the nest egg (approximately 4% of the value of the nest egg at current interest rates) if she did not want to pay any tax on the interest received by Paula. If Alice transferred such a sum to Paula, Alice would save £20 in tax a year (£40 if Alice was a higher rate taxpayer). Hardly worth the trouble!

However, there **are** some very effective ways in which you can avoid this rule. In order to understand what they are, lets return to the rule governing parent/child asset transfers, for a moment.

The rule, as quoted previously, states;

> **"***If **you** give your child an asset or assets that produce more than £100 of **taxable income** per year, all of that income will be still be treated as yours and taxed as part of your income*."

There are two key points;

- Firstly, you have to **give the assets yourself,** and

[3] This applies to the income produced by the asset **before** any deduction for personal allowances etc.

- Secondly, the income has to be **"taxable" income**

You will therefore **not be taxed** if your child is given assets that generate income of more than £100 a year **if** that income;

- Arises from assets that were not given by yourself, or

- Is not "taxable income"

This leads to 5 specific ways in which assets that generate more than £100 of income a year can be given to your child without you having to pay tax on this income. These options are as follows;

- **Invest in an ISA** on behalf of your children,

- **Invest in National Savings Certificates and/or Children's Savings Bonds** on behalf of your children,

- Get your parents (**the children's grandparents**) **to transfer assets** to your children.

- Set up an **Accumulation and Maintenance Trust** for your children

- Invest in a **Children's Trust Fund.**

Lets discuss all of these options in turn and explain why any income generated in this way is **not** taxed as yours.

5.6.1 Invest in an ISA

ISAs are explained in detail in Section 10. If you do not know about ISAs, or how they work, you may find it helpful to jump ahead for a moment and read 10.1.

One of the good things about ISAs is that you do not pay tax on income earned by assets in an ISA;

- You do not pay tax on interest income, and

- You do not pay tax on dividend income that you receive (although you cannot reclaim the 10% tax that is deducted from the dividend before it is paid to you).

The income earned in an ISA is, therefore, not "taxable income". As it is not taxable income, it does not get caught by the £100 rule. You can therefore invest in an ISA on behalf of your child and ***any amount of income*** can be earned for the benefit of your child without you, or your child, having to pay any additional tax.

<table>
<tr><td>TIP</td><td colspan="3">If you want to give assets to your child that generate more than £100 of investment income a year <u>without</u> paying any tax yourself on that income, you should consider investing in an ISA on behalf of your child.</td></tr>
<tr><td>SAVE</td><td>£1,000s</td><td>EASE OF USE</td><td>Simple</td></tr>
<tr><td>CONSIDER</td><td colspan="3">The investment in the ISA on your child's behalf will be treated as a gift for Inheritance Tax purposes. See Section 20.</td></tr>
<tr><td>What you need to do</td><td colspan="3">You should discuss your requirements with an IFA.</td></tr>
</table>

5.6.2 Put money in investments which generate non-taxable income

The two most common forms of investments that produce **non-taxable income** are **National Savings Certificates** and **Children's Bonds** (see Section 10).

As the income generated from these investments is **not taxable**, it does not matter if the annual income earned by your child from these investments exceeds £100 per year – you will not pay tax on this income.

Lets look at each of these investments in turn.

National Savings Certificates

National Savings Certificates are available in separate "issues", which have their own interest rate and investment limit.

You can get Certificates that pay a fixed rate of interest or an "index linked" rate of interest.

Fixed Interest Certificates last for 2 or 5 years (the "term" of the Certificate) and can be bought in units of £100 up to a current maximum limit of £15,000 per issue.

The current issue of Fixed-Interest Certificates is paying 3.05% interest on both the 2-year and 5-year term investments.

Index-linked Certificates last for 3 or 5 years and can be bought in units of £100 up to a current maximum of £10,000.

The interest rate is "index linked", so that it varies in line with changes in the Retail Price Index ("RPI"). This means that, if inflation rises, you will get more interest paid to you.

The interest rate also gradually increases over the term of the Certificate, so that you earn less interest in the first year of the term than you do in each of the remaining years.

The average interest rate across the whole of the term for the current issues of Certificates are 0.90% plus any change in the RPI for the 3-year Certificate and 0.95% plus any change in the RPI for the 5-year Certificate.

Children's National Savings Bonus Bonds

Like National Savings Certificates, Children's National Savings Bonus Bonds are available in separate "issues", which have their own investment limit. Each time a new issue comes out, you can invest up to this limit, tax-free.

Children's National Savings Bonds last for five years and can be bought in units of £25 up to a current maximum limit of £3,000 per issue.

The interest rate paid on the Bonds is fixed. The current issue (on 1st May 2006) is paying an interest rate of 3.85%, which is made up of 2.95% each year for the first five years with a bonus at the end of 5.16%.

At the end of the investment period, you can leave your money in the Bond earning a new tax-free rate of interest for a further five years, or until the child is 21, when a final bonus is added. And if the child starts work and becomes a taxpayer before cashing in their Bond, it makes no difference - the interest and bonuses remain tax-free

In conclusion

There are three good things about National Savings Certificates and Children's National Savings Bonus Bonds;

- Firstly, they are backed by the Government, so there is **no chance of you losing your money**;
- Secondly, **all interest is received tax-free**; and
- Thirdly, they are **easy to buy** – just go to the Post Office, or call 0845 964 5000, and ask for a form.

The purchasing of National Savings Certificates and Children's Bonds on behalf of your child is therefore a neat way of transferring assets to your child without being exposed to an income tax bill on any income that is earned.

TIP	If you want to provide your child with access to more than £100 of income a year **without** paying any tax yourself on that income, buy them investments that produce non-taxable income – such as National Savings Certificates and Children's Bonds.		
SAVE	£1,000s	**EASE OF USE**	Simple
CONSIDER	The purchase of an asset on your child's behalf will be treated as a gift for Inheritance Tax purposes. See Section 20.		
What you need to do	Call National Savings and Investments on 0845 964 5000 and ask for an application form for National Savings Certificates and/or Children's Bonds, or get a form from your local post office.		

5.6.3 Transferring income from grandparents

Whilst there **are** rules in place to stop ***parents*** giving assets to their children just to take advantage of their children's personal allowance, there are **no rules** to prevent ***grandparents or other relatives*** giving assets to the child for this purpose.

So, if a grandparent gives assets that generates more than £100 of taxable income a year to a grandchild, the grandparent will **not pay tax** on this income from the date that the assets are transferred.

As long as the income generated by these, and other assets previously owned by the child, is less than the child's personal allowance (£5,035 for 06/07, £4,895 for 05/06), the child will not pay tax on this income.

Thus;

- Prior to the transfer of assets, the income earned by the grandparents from the assets is taxed;
- After the transfer of assets, the income earned by the grandchildren from the assets is not taxed;

and the family unit as a whole saves income tax.

This is an easy and effective way of utilising your child's Personal Allowance, whilst also providing for future education fees.

TIP	Transfer assets from a grandparent to a grandchild so that income from these assets is earned tax-free.		
SAVE	£100s	**EASE OF USE**	Simple
CONSIDER	The transfer of an asset will be treated as a disposal for Capital Gains Tax purposes, so the transferor (the grandparent in this case) will need to make sure that any gains are covered by his/her annual Capital Gains Tax allowance. See Section 19. There may also be Inheritance Tax implications. See Section 20.		
What you need to do	Decide what assets are going to be transferred – cash, shares? Check that you are not transferring assets that will generate income that, when taken together with any other income received by the child, will take the child's total taxable income over their personal allowance Make legal transfers of the assets from grandparent(s) to the child(ren)		

5.6.4 Set up an Accumulation and Maintenance Trust

If you don't mind, we won't discuss this just yet! Trusts can be quite complicated, and they are discussed in detail later in this Guide.

If you want to understand this particular tip now, you should read Appendix 2 first and then read 20.16. After this, you should understand how the creation of an Accumulation and Maintenance Trust gets around the “£100 rule”.

5.6.5 Child’s Trust Fund

From April 2005, all children born after 31 August 2002 receive a £250 voucher from the Government.

If a child is part of a household receiving Child Tax Credit with a household income below the Child Tax Credit income limit (£14,155 for 06/07, £13,910 for 05/06), the child also receives an extra voucher for £250.

Each child also receives a further voucher of £250 on his or her seventh birthday (which is increased to £500 if the child is part of a household that is receiving Child Tax Credit).

The vouchers are used to open up special “Trust Fund” accounts, which are offered by many companies. You can choose what type of asset the money gets invested in – cash, shares, life insurance products etc.

The money is “locked in” until a child reaches 18. The money cannot be obtained before then.

The accounts operate like ISAs (see Section 10) and all income and capital gains earned in the Fund are tax-free.

Anybody can contribute up to £1,200 a year per person to a Trust Fund account, but there is no tax relief on these contributions. The person that pays them does so out of his or her after-tax income.

As income earned by the Trust Fund is not taxable, a parent can invest into the Trust Fund on behalf of a child without worrying about being taxed on the income generated by the Trust Fund.

Important: A Child Trust Fund is a tax effective way of providing for your child, but any income earned by the investments in the Fund has to be kept in the Fund until the child is 18. This is not a viable option if you want your Child to be able to use the income earned before he/she reaches this age (e.g. for education purposes).

<table>
<tr><td>TIP</td><td colspan="3">Put money away for your children in their Trust Fund account and let this money grow tax-free</td></tr>
<tr><td>SAVE</td><td>£1,000’s</td><td>EASE OF USE</td><td>Simple</td></tr>
<tr><td>What you need to do</td><td colspan="3">If your child is eligible, a voucher will automatically be sent to the Child Benefit Claimant.

The voucher can be used by a person with parental responsibility to open a Child Trust Fund account for the child with a provider of your choice.

Information packs will accompany the voucher giving you information about what you need to do.

If a Child Trust Fund account is not opened within a year from the date of issue of the voucher, the Inland Revenue will open an account for the child.</td></tr>
</table>

5.7 Transferring assets to your child

In 5.6, we talked about how you should consider transferring assets to your children, so that you don't pay tax on the income earned by those assets.

The motivation for transferring assets was to reduce your own income, so that you paid less tax.

There may be other reasons why you want to transfer assets to your children. For example, the giving of assets is a common way of looking to reduce your Inheritance Tax bill (see Chapter 20).

Whatever the reason, you will always need to bear in mind that **you** will pay tax on any taxable income earned on the assets if it exceeds £100 a year, unless you have used one of the Tips that we outlined above.

If you want to transfer assets to your children, but it is **not important** that your children earn income from the assets immediately, you should consider investing for your children in investments that will produce **capital gains**, rather than **income**. (Take a minute and refer back to 2.2 if you cannot remember the difference between these two terms). You will not be taxed on the capital gains that are made by your child on assets given by you, **no matter how large these gains are** (there is no capital gains equivalent to the "£100 income" rule).

In this way;

- You will not pay tax on any income earned by the assets, as long as it remains below the £100 a year limit referred to in 5.6 above, and

- Your child will not pay tax on the income earned as long as his/her annual income remains below the level of the Personal Allowance (£5,035 in 06/07, £4,895 for 05/06), and

- Your child will not pay Capital Gains Tax (see Section 19) on any gain made when the assets are sold, as long as the gains are less than the child's annual capital gains exemption (which is £8,500 for 05/06 and £8,800 for 06/07).

By investing in assets that generate a low level of income, but a high capital growth, you can give your children the benefit of asset ownership without exposing yourself to an income tax bill on any income earned.

TIP	If you want to give assets to your children but you do not want to pay income tax on the income earned on these assets, you should consider investing on behalf of your children in low-income, high-growth, assets		
SAVE	£100s	**EASE OF USE**	OK
CONSIDER	The transfer of an asset will be treated as a disposal for Capital Gains Tax purposes, so the transferor will need to make sure that any gains are covered by his/her annual Capital Gains Tax allowance. See Section 19. There may also be Inheritance Tax implications. See Section 20.		
What you need to do	Speak to an Independent Financial Adviser (IFA) – read Section 23 for advice on how to find one – and tell them that you want to invest in a low-income, high capital growth, asset in your child's name. Your IFA will recommend alternatives to you based on how much risk you want to take. We suggest that you opt for a relatively low risk investment and that you do not look to invest in a single company's shares.		

5.8 Accumulation and Maintenance Trusts

As we mentioned in 5.6.4 above, Trusts are quite complicated and the whole area is addressed in detail later in this Guide. However, there is one important point that we need to make about Accumulation and Maintenance Trusts before we go on, as such Trusts are commonly used to provide for children and grandchildren in a tax-efficient way.

Up until 5th April 2004, there were certain income tax advantages of providing for your children through an Accumulation and Maintenance Trust. These advantages partly arose from the fact that the Trust was liable to pay income tax at lower rates than individuals.

In 2003/04, an Accumulation and Maintenance Trust was liable to pay tax;

- on savings income at a rate of 34%, and
- on investment income at a rate of 25%

Both rates were significantly lower than the rates that applied to higher rate taxpayers in 2003/04.

However, since 5th April 2004, an Accumulation and Maintenance Trust has been required to pay tax on savings income at a rate of 40% and on investment income at a rate of 32.5%, which are the same as those rates that apply to a higher rate taxpayer. As the tax rates are now the same, one of the main tax advantages of Trusts has been removed.

However, subject to recent changes announced in the 2006 Budget (and which are outlined in 20.16.1 below and Appendix 2) trusts remain an excellent way of minimising Capital Gains and Inheritance Tax - these advantages are described in Sections 19 and 20 – and they remain an excellent way of providing income to your children and avoiding the £100 rule (see 5.6.1. above and 20.16.1 below).

WARNING	From 6th April 2004 onwards, you can not save income tax by putting assets into an Accumulation and Maintenance Trust.

5.9 Other relevant tips elsewhere in this Guide;

- Pay your spouse and children (see 9.3.3)
- Students (all of Section 13)
- Inheritance Tax (all of Section 20)

6 THE ELDERLY

You should read this Section if you are aged 60 or over in the current tax year.

In this Section you will learn;

- **About the tax allowances that can only be claimed by the elderly**
- **How to maximise these tax allowances**
- **About when you can stop paying National Insurance Contributions**
- **Why a purchased life annuity can save you tax**

6.1 Higher Personal Allowance

If you are aged **65 or over** in the tax year, you will receive a higher Personal Tax Allowance. This "Age Allowance" is given **instead of** the normal Personal Allowance.

Figure 5: Age Allowances for 2005/06 and 2006/07

Age in the tax year	2005/06	2006/07
65 to 74	7,090	7,280
75 or over	7,220	7,420

The "Age Allowance" is **reduced** at the rate of £1 for every £2 that your income for the tax year is above a limit (which is £19,500 for 2005/06 and £20,100 for 2006/07), until you reach the "Minimum Allowance".

The "Minimum Allowance" is the normal Personal Allowance for that year, i.e. £4,895 for 2005/06 and £5,035 for 2006/07.

In calculating your income for these purposes, you are allowed to;

- Ignore tax-free income,
- Deduct gross pension contributions (see Section 18),
- Deduct charitable donations that qualify for tax relief (see Section 12),
- Deduct loan interest that qualifies for tax relief,
- Deduct business losses (see Section 8).

EXAMPLE

George Barratt was 72 on 1st October 2005. During 2005/06, he received a pension of £15,500, interest of £3,250 (gross) and dividend income of £2,450 (gross). In October 2005, George made a "Gift Aid" donation to Cancer Relief of £1,500 (gross).

George's income for 2005/06 for the purposes of calculating his "Age Allowance" is £19,700 (being £15,500 plus £3,250 plus £2,450 less £1,500).

This income is £200 above the income limit of £19,500. His Age Allowance is therefore reduced by £100. George will therefore receive an "Age Allowance" of £6,990 (being £7,090 less £100) for 2005/06.

TIP	If you are over 65 in the tax year, claim your "Age Allowance"		
SAVE	£100s	**EASE OF USE**	Child's play
What you need to do	Enter your date of birth in box 22.6 on your Tax Return		

6.2 Married Couples Allowance

A married couple living together are entitled to receive the Married Couples tax allowance if **either spouse** was born before 5th April 1935.

The Married Couples allowance is given **as well as** the Personal Allowance/Age Allowance.

Where the eldest spouse is aged between 65 and 74 during the tax year, the allowance is £5,905 for 2005/06 (£6,065 for 2006/07). Where the eldest spouse is aged over 75 at any time during the tax year, the allowance is £5,975 for 2005/06 (£6,135 for 2006/07).

IMPORTANT: Tax relief is only given at the rate of 10%, and **not** at the highest rate of tax paid by the taxpayer. This means that the allowance of £5,905 for 2005/06 is always worth £590.50 in reduced tax to the taxpayer, and the allowance of £5,975 is always worth £597.50 in reduced tax to the taxpayer, no matter what their level of income.

ILLUSTRATION

In 2005/06, Sam Peebles received a total pension of £17,300. Sam was 72 on 12th December 2005 and his wife, Bertha, was 76 on 20th January 2006.

Sam can claim a married couples allowance of £5,905 as well as the "Age Allowance" of £7,090.

Sam's taxable income is therefore calculated as follows;

Pension income	*17,300*
Less: Age Allowance	*(7,090)*
	10,210
Less: Married Couples Allowance	*(5,905)*
Taxable income	*4,305*

Sam's tax bill is worked out as follows;

On £10,210:	
£2,090 at 10%	*209.00*
£8,120 at 22%	*1,786.40*
	1,995.40
Less: Deduction for Married Couples Allowance	*(590.50)*
Total tax bill	*1404.90*

*It is easiest to calculate the tax based on the taxable income **before deduction of the married couples allowance**, and then deduct 10% of the married couple's allowance.*

The allowance is **not given** to people **automatically** – it has to be claimed on the Tax Return.

The allowance is **reduced in the year of marriage** by one-twelfth for each complete month from 6th April up to the date of marriage.

TIP	Claim married couples allowance		
SAVE	£100s	**EASE OF USE**	Child's play
What you need to do	Tick the "yes" box in Question 16 of your Tax Return and fill in boxes 16.3 to 16.17		

6.2.1 Restriction of Allowance

The Married Couples Allowance is restricted in the same way as the Age Allowance when income, **after allowable deductions**, exceeds a specified limit. (*NB: Refer back up to 6.1, "Higher Personal Allowances", if you cannot recall what deductions are allowable in calculating your income).*

The limit is the same for both Allowances, namely £19,500 for 2005/06 and £20,100 for 2006/07, and the reduction in the Married Couples Allowance is calculated in the same way as the reduction in the Age Allowance, namely £1 for every £2 by which income is more than the limit.

The Married Couples Allowance cannot be reduced below a minimum level, which is £2,280 for 2005/06 and £2,350 for 2006/07).

IMPORTANT: For couples married **before 5 December 2005**, the reduction in the married couple allowance is calculated by referring solely to **the husband's income**. It is unaffected by the income of his wife, **no matter how much she earns.** For couples married **after 5 December 2005**, the reduction is calculated by referring to the income of the higher earner.

Where you are claiming both the Age Allowance and the Married Couples Allowance, **the Age Allowance reduces first.** This is a little complicated and is best illustrated by way of example.

ILLUSTRATION

Simon and Jane Geekie are both 72. Simon's income, after deductions, for 2005/06 was £25,300.

The income limit for the Age Allowance and the Married Couples Allowance for 2005/06 is £19,500.

Simon's income exceeds this limit by £5,800, which will result in a total reduction of £2,900 in Simon's Age Allowance and the Married Couples Allowance (being £1 for every £2 that Simon's income exceeds the income limit for these allowances).

Simon's Age Allowance for 2005/06, before reduction, is £7,280. This is reduced by £2,385, to take it down to the Minimum level of £4,895. The Allowance cannot be reduced below this Minimum level.

Simon's Married Couples Allowance for 2005/06, before reduction, is £5,905. This is reduced by £515 (being £2,900 less £2,385), to give an Allowance of £5,390.

Simon will therefore pay tax on taxable income of £15,015 (being £25,300 less £4,895 less £5,390).

Figure 6 overleaf shows how the Married Couples Allowance changes for;

- different levels of the husband's income, and
- the ages of the husband and wife.

Figure 6 – Married Couples Allowance

	2006/2007 tax year
Level of income when age related allowances start to be reduced	**£20,100**
Level of income after which no age- related allowance is payable:-	
Single person aged 65-74, or married woman aged 65-74	£24,590
Single person aged 75 or over, or married woman aged 75 or over	£24,870
Married man aged under 65 but wife born before 6 April 1935 and under 75	£27,530
Married man aged under 65 but wife 75 or over	£26,670
Married man aged 65-74 where he and his wife were born after 5 April 1935	£24,590
Married man aged 65-74 where he or his wife were born before 5 April 1935	£32,020
Married man aged 65-74 and wife aged 75 or over	£32,160
Married man aged 75 or over	£32,440
Minimum amount of married couple's allowance	**£2,350**

The difference between the maximum and minimum Married Couples allowance is worth £3,785, which is worth £378.50 in saved tax a year (remember that the tax relief is restricted to 10% on this allowance).

It clearly makes sense to keep the husband's income below the level at which the Married Couples allowance is restricted (£19,500 in 2005/06 and £20,100 in 2006/07), if at all possible.

One way in which this might be achieved, for those couples married before 5 December 2005, is by **transferring income-generating assets into the ownership of the wife**.

TIP	Keep the husband's taxable income below the income limits that are applied in calculating Married Couples Allowance, by transferring income-generating assets to his wife.		
SAVE	£100's	**EASE OF USE**	OK
What you need to do	Decide whether the husband is happy to transfer his income-generating assets to his wife Estimate or calculate by how much the husband's taxable income will exceed his relevant income limit (use Figure 6 above) Identify what income-generating assets need to be transferred from the husband to the wife to reduce his taxable income below this limit (or to as small an amount as possible if this limit cannot be reached) Make legal transfers of the assets.		

There is an alternative solution to this problem.

A man does not have to transfer his assets to his wife to reduce his taxable income. Instead, he can reduce his taxable income by changing the assets in which **he** invests.

For example, he can move his money from investments which produce taxable income to;

- Investments which produce income that is **not** taxed, such as National Savings issues or Individual Savings Accounts (see Section 10); **or**

- Investments which generate a low taxable income, but a high capital growth.

TIP	Keep the male partner's taxable income below the relevant limit for Married Couples Allowance, by investing in assets that **provide income that is not taxable.**		
SAVE	£100s	**EASE OF USE**	Simple
What you need to do	Individual Savings Accounts – see 10.1 National Savings Certificates: Call 0845 964 5000 for an application form.		

TIP	Keep the male partner's taxable income below the relevant limit for married couples allowance, by investing in assets that **generate capital gains rather than income.**		
SAVE	£100s	**EASE OF USE**	Simple
What you need to do	Speak to an Independent Financial Adviser (IFA) – see Section 23 - and tell them that you want to invest in low-income, high capital growth, assets. Your IFA will recommend alternatives to you based on how much risk you want to take.		

When it comes to deciding whether you should use any of the Tips that relate to the Married Couples Allowance, you will need to consider what income is needed from the investments in order to pay for living expenses, as well as how comfortable the man is transferring assets to his female partner! My guidance would be as follows;

- If the husband is happy to transfer assets to his wife, he should do so,

- If the husband does not want to transfer assets to his wife, and he needs to earn a reasonable income from his assets, he should invest in National Savings issues and/or in Individual Savings Accounts,

- If the husband does not want to transfer assets to his wife, and he does **not** need to earn an income from his assets, he should consider investing in assets that will generate capital gains (such as High Growth Unit Trusts) **as well as** assets that generate income. If the husband has not used up his annual ISA investment limit, he should invest in such assets through an ISA.

6.2.2 Transferring Surplus Allowance

If the husband has insufficient income to fully utilise the Married Couples Allowance, he should transfer any "surplus allowance" to his spouse.

You are **not allowed** to transfer surplus Personal Allowances or Age Allowances to your spouse, as these relate to *the individual*.

However, you **are allowed** to transfer surplus Married Couples Allowance to your spouse because, even though the Allowance is given to the husband, it relates to the *couple*. It is only right, therefore, that both parties can benefit from it.

EXAMPLE

On 12th December 2005, Irene Vokes, who was 73 in July 2005, married Cyril Barratt, who was 64 in December 2005.

Cyril had taxable earnings of £5,500 in 2005/06 and Irene had taxable earnings of £15,450.

As Irene (being the eldest spouse) was born before 5th April 1935, and was between 65 and 74 in the tax year, the couple can claim the married couples allowance of £5,905 for 2005/06. However, this needs to be reduced, as they were not married for the whole tax year.

There were 8 complete months in the tax year when they were not married (6th April to 6th December), so the allowance is reduced by 8/12. They are therefore entitled to an allowance of 4/12 x 5,905 = £1,968

Their tax calculations for 2005/06 are therefore as follows;

	Cyril	***Irene***
Taxable earnings	*5,500*	*15,450*
Less; *Tax allowances*		
Personal allowance (aged less than 65)	*(4,895)*	*-*
Personal age allowance (aged between 65 and 74)	*-*	*(7,090)*
Married couple's allowance	*(1,968)*	*-*
Net taxable income	*(1,363)*	*8,360*
Transfer of surplus allowances from Cyril to Irene	*1,363*	*(1,363)*
Taxable income for 2004/05	***-***	***6,997***

The transfer of surplus allowances reduces Irene's taxable income by £1,363. Irene will save £136 in tax because of this transfer (remember, the tax relief from the Married Couples Allowance is restricted to 10%)

TIP	Transfer surplus married couples allowance to your spouse		
SAVE	£100s	**EASE OF USE**	Simple
What you need to do	If the husband has claimed the allowance: He should tick box 16.14 on his Tax Return and his wife should tick box 16.15 on her Tax Return If the wife has claimed the allowance: She should tick box 16.14 on her Tax Return and her husband should tick box 16.15 on his Return		

6.2.3 Transferring the entire Married Couples Allowance

The Married Couple's Allowance will save the same amount of tax, no matter which party claims it, as the tax relief on the allowance is restricted to 10%.

However, if the wife is employed and the husband is self-employed, switching the allowance to the wife will reduce her tax from the **beginning of the tax year** (as her tax code will be changed). If the allowance is kept with the husband, he will only benefit from it **later in the year** when he starts to make payments of tax on his profits.

Transferring the Allowance in this way will not save you tax, but it will give you the benefit of the Allowance ***earlier*** in the tax year. Note: You should only do this if the wife is paying tax at a rate which is the same, or higher, than that paid by her husband.

TIP	Transfer the married couples allowance to the female partner if she is employed and her husband is self-employed and she pays tax at the same (or higher) rate as her husband.		
SAVE	£10s	**EASE OF USE**	Simple
What you need to do	Tick the "yes" box in Question 16 of your Tax Return and fill in boxes 16.3 to 16.8 and 16.9 to 16.17		

6.3 Winter Fuel Payment allowance

You can claim a Winter Fuel Payment Allowance for 2006/07, if you were 60 or over on 24th September 2006.

6.3.1 How Winter Fuel Payment allowance is calculated

The table below illustrates how this allowance is calculated.

Circumstances	Aged 60 to 79 on or before 24 September 2006	Aged 80 or over on or before 24 September 2006
You live alone or are the only person in the household who qualifies	£200	£300
You get Pension Credit or income-based Jobseeker's Allowance	£200	£300
You live with another qualifying individual	£100	£200 if you're the only person in the household who's aged 80 or over £150 if you and at least one other person are aged 80 or over
If your partner or civil partner gets Pension Credit or income-based Jobseeker's Allowance for you both	You don't qualify for Winter Fuel Payment	You don't qualify for Winter Fuel Payment
You live in a care home and don't get Pension Credit or income-based Jobseeker's Allowance	£100	£150
You live in a care home and get Pension credit or income-based Jobseeker's Allowance	You don't qualify for Winter Fuel Payment	You don't qualify for Winter fuel payment

6.3.2 Claiming the Winter Fuel Payment

If you did not receive your payments automatically for Winter 2005, you have now missed the deadline (30th March 2006). The deadline for claiming your Winter 2006 payment is 30th March 2007.

If your claim is successful this winter, you will get the payment automatically in the future.

If you have not received Winter Fuel Payment allowance in the past, and you will be aged 60 or over on 24 September 2006 and getting a State Pension or other benefit (not including Housing Benefit, Council Tax benefit or Child Benefit) there's no need to apply - Winter Fuel Payment should be paid to you automatically. If you aren't getting a State Pension or benefits (or only receive Housing Benefit, Council Tax Benefit or Child Benefit) - you'll need to claim.

The Winter Fuel Payment is not taxable and it does not affect any other pensions or benefits that you get.

Help the Aged estimate that as many as 40,000 eligible people fail to claim this payment each year. Don't be one of them!

TIP	Make a claim to receive your Winter Fuel Allowance		
RECEIVE	£100's	**EASE OF USE**	Simple
What you need to do	Make your claim by calling 0845 9151515		

6.3.3 Claiming for previous years

A little bizarrely, if you did not claim a Winter Fuel Payment for 1997/98, 1998/99 and 1999/2000, you can still do so, as long as you were aged 60 or over by the end of the qualifying week for those years and, for those weeks, you were eligible to receive the payment[4].

The qualifying weeks for those years were;

Year	Week
1997/98	5 to 11 January 1998
1998/99	9 to 15 November 1998
1999/2000	20 to 26 September 1999

TIP	Make a claim to receive your Winter Fuel Allowance for previous years		
RECEIVE	£100's	**EASE OF USE**	Simple
What you need to do	Make your claim by calling 0845 915 1515		

6.3.4 Council Tax

In 2005/06, pensioners were given a £200 payment towards Council tax. This has been stopped from 6 April 2006.

6.4 Claim a free TV licence

People aged over 75 can claim a free TV licence. You will not receive a free licence automatically once you turn 75 - **you have to apply for it**.

When you receive your next TV licence reminder, it should include an application form for a free licence.

If it doesn't, you should call the TV licensing information helpline on 0845 603 6999, 8 am to 9 pm Monday to Friday, and ask for an application form to be sent to you.

If you are 74 and your licence runs out after your 75th birthday, call the helpline number above and ask them to convert your current licence to a short term licence that expires on your birthday.

When you call the helpline number, it will speed up your enquiry if you have your current TV licence number and national insurance number to hand.

[4] The eligibility criteria in previous years were slightly different to those that currently apply. Call 0845 915 1515 to find out how.

TIP	Claim your free TV licence		
SAVE	£100's	**EASE OF USE**	Simple
What you need to do	Call 0845 603 6999 and ask for an application form to be sent to you.		

6.5 National insurance contributions

6.5.1 Stop paying National Insurance contributions

Once you've reached retirement age (60 for women and 65 for men) you do not have to pay National Insurance contributions (NICs).

If you are self-employed, you do not pay NICs after the 5^{th} of April following your 60/65th birthday.

If you are working and contributions are still being deducted from your salary, you should contact your Tax Office immediately.

TIP	If you are still employed after the normal retirement age, make sure that National Insurance contributions are not being deducted from your salary. If they are, contact your Tax Office immediately.		
SAVE	£100's	**EASE OF USE**	Simple
What you need to do	Contact (call or write to) your Tax Office and tell them of your circumstances		

6.5.2 Get credited with National Insurance Contributions even if you don't pay them!

If you are a man aged over 60, you are not working and you are resident in the UK for at least six months of each tax year, you are entitled to be credited with full National Insurance contributions until you are 65.

This means that the pension that you receive upon your retirement will be the same whether you work between the age of 60 and 65 or not.

You should check with the National Insurance Contributions Office that you are being credited with National Insurance contributions if you are not paying them. You can contact them on 0191 213 5000.

TIP	Make sure that you are being credited with full national insurance contributions if you are an unemployed man, aged between 60 and 65.		
SAVE	£100's	**EASE OF USE**	Simple
What you need to do	Call the National Insurance Contributions Office on 0191 213 5000		

6.6 Get a "Purchased Life Annuity"

A "Purchased Life Annuity" basically involves the payment of a large sum up-front, in return for a guaranteed income for the rest of one's life.

In most cases, you will be required to invest a minimum lump sum of £20,000 (or even higher) in order to purchase an annuity, so you will probably only be in this position in exceptional circumstances – such as when you retire and take part of your pension as a tax free lump sum, or when you have been the beneficiary of a will, or when you are trading down in property size.

We mention purchased life annuities because amounts received from them are treated **more beneficially for tax purposes** than a normal pension;

- A pension that you receive from a pension scheme is fully taxable;

- Each receipt from a purchased life annuity is treated partly as a return of the amount paid for it (the capital element) and partly as interest (the income element). Whereas the income element is liable to income tax in full, the capital element is tax-free.

For illustration purposes only, Figure 7 below shows the tax-free income that a person might receive per £1,000 of income from the annuity.

Figure 7: Tax-free income per £1,000 of annuity income

Age Now	Male	Female	Joint
55	692	677	679
60	713	685	686
65	832	770	782
70	852	827	830
75	908	831	841
80	940	833	873

Figure 7 shows that the older the annuitant is when acquiring a purchased life annuity, the higher the capital element and as a result, the lower the tax liability on the income.

ILLUSTRATION

A male basic rate taxpayer aged 70 will pay tax on £148 per £1,000 of income (being £1,000 less £852), whereas a 60 year old will pay tax on £287 per £1,000 (being £1,000 less £713).

EXAMPLE

In terms of tax treatment, let us look at the example of a male basic rate taxpayer aged 60 who buys a purchased life annuity with £50,000[5].

Lets assume that he receives an annual income of £6,530 gross.

*Using Figure 7 above, £4,655.89 of this will be treated as repayment of **capital** and is therefore paid tax-free;*

£6,530 x 713/1000 = £4,655.89

*The balance of £1,874.11 (£6,530 less £4,655.89) will be treated as **income**, from which the insurance company must deduct tax at source of 20% (or £374.82) and pay this to the Inland Revenue.*

This means the annuitant receives;

Tax free capital sum	*4,655.89*
Income (after tax deduction)	*1,499.29*
Total receipt	***6,155.18***

A basic rate taxpayer will have no further tax to pay on this receipt, resulting in him paying tax at an effective rate of 5.74% on the money that he receives from the annuity (5.74% being £374.82 divided by £6,530).

This compares very favourably with the 22% tax rate payable on a pension. The effective tax saving from purchasing a life annuity is £1,061.78.

[5] Purchased as a level annuity, with no guarantee, without proportion and paid monthly in arrears

For a higher rate taxpayer, the tax benefits are more significant. A higher rate taxpayer would have to pay a further £374.82 on the annuity income, resulting in an effective tax rate of 11.48%, whereas he/she would pay tax at a rate of 40% on a pension. The effective tax saving would be £1,862.36.

In conclusion;

- **when you retire**, you will pay less tax if you take the maximum tax-free lump sum that you can and purchase a life annuity with it, rather than leaving it in your pension.

  However, if you are financially secure and you do not need the lump sum, and the total value of your assets is more than the Inheritance Tax limit (£275,000 for 05/06, £285,000 for 06/07), you should consider gifting the lump sum to your relatives. See Section 20 on Inheritance Tax.

- If you have a lump sum to invest **before you retire**, your decision is not quite so straightforward. This is because you get tax relief for contributions to a pension scheme when you make them. This is explained in Section 18. In these circumstances, we recommend that you take professional advice from an IFA.

Typically, **only people over 55** should consider investing in purchased life annuities.

Note: There are a number of options to choose from when purchasing an annuity, including the "guaranteed period" (the period over which the income will received, even if you die in the meantime) and "capital protection" (which ensures that if the annuitant dies earlier than expected, his/her estate will receive the difference between the income received from the annuity and the cost of the annuity in the first place). This is a complex area and we recommend that you speak to an Independent Financial Advisor if you are considering purchasing a life annuity.

Further Note: If you are buying an annuity with all or part of a lump sum received from a pension, you do not have to buy an annuity from the company that provides you with your pension. By law, personal and stakeholder pensions **must** give you the option to buy your annuity from anyone you want.

TIP	When you retire, consider taking the maximum tax-free lump sum and investing it in a Purchased Life Annuity. If you have a lump sum to invest before you retire, and you want to use it to provide for your future, take advice from an IFA about whether to invest directly into a pension or into a purchased life annuity.		
SAVE:	£1,000's	**EASE OF USE**	Difficult
CONSIDER	Giving the lump sum away if your assets are worth more than the Inheritance Tax threshold (£275,000 for 05/06, £285,000 for 06/07), to avoid Inheritance Tax.		
What you need to do	Speak to an IFA about the most suitable life annuity to purchase.		

6.7 Your retirement date

Around 3 or 4 months before you are due to retire, you should receive a form from the Department for Work and Pensions (DWP).

By completing this form, you will advise the DWP of when you want to receive your state pension and how you want it paid.

At the same time, you should inform your Tax Office of when you are due to receive your pension, so they can make any necessary adjustment to your tax code.

TIP	Tell the authorities of your retirement plans to avoid over-paying tax and National Insurance Contributions		
SAVE	£100's	**EASE OF USE**	Simple
What you need to do	Contact your Tax Office and tell them when you are going to start receiving your pension		

6.8 Other relevant Tips elsewhere in this Guide;

- Life assurance policies (see 10.16)
- Pensions (all of Section 18)
- Inheritance Tax (all of Section 20)
- Council Tax (see 21.1)

7 PEOPLE WHO ARE EMPLOYED

You should read this Section if you are employed, or have been employed in the tax year.

In this Section, you will learn;

- **why you should always check your tax code, your P11D and your P60**
- **the most common reasons why employees pay too much tax**
- **how to reduce the tax that you pay on your fringe benefits**
- **what benefits you can receive from your employer without paying any tax**
- **what expenses you can claim against tax**
- **whether to take salary or dividend if you own your own business**
- **about Employee Share Plans**
- **how to pay less tax on redundancy and relocation payments**

7.1 Introduction

If you are employed, you will typically;

- have a contract of employment with your employer, setting out the terms and conditions of your employment,
- earn a fixed wage or a salary, and
- will be paid even when you take holiday leave.

This section is relevant to you if you own your own company and are employed by it, but it is not relevant to you if you operate in business as a sole trader, as a partner in a partnership, as an independent contractor or as a consultant. In these instances you are deemed to be self-employed and you should refer to Section 8.

If you have your own company, **you** will be taxed as an employee on any wages that you draw from that company and any benefits that you receive from the company and **you** will be taxed on any dividends that you are paid by that company. The company will have to pay Corporation Tax on its taxable profits.

7.1.1 Your tax code

As an employee, you will be issued with a tax code by your Tax Office. The tax code tells your employer how much tax to deduct from your earnings. The tax code is a number followed by a letter;

- the **number** in your tax code represents the amount of tax-free income that you will earn in the tax year divided by 10, and
- the **letter** is a means of identifying the type of taxpayer.

Let us look at each component of the tax code in detail.

7.1.2 The number

In simple terms, your tax-free income is calculated by taking your tax allowances and deducting the taxable value of the fringe benefits that you receive from your employer (see 7.7 for a description of "fringe benefits"). There may also be an adjustment for any under or over payment of tax from previous tax years (if you have chosen not to pay/receive these amounts directly to/from the Inland Revenue) and for items on which you get tax relief, such as pension contributions.

Your tax-free income is then divided by 10, and the answer is rounded up to the nearest whole number. This gives you your tax code number.

The way in which the Inland Revenue has calculated your tax-free income is shown on your PAYE Coding Notice (see 7.1.4 below).

7.1.3 The letter

The letter denotes the following;

- L is for a code based on the basic Personal Allowance
- P is for a code based on the Personal Age Allowance
- V indicates that the taxpayer is a pensioner who is entitled to the Personal Age Allowance **and** the Married Couples Allowance for age 65-74
- Y indicates that the taxpayer is a pensioner who is entitled to the Personal Age Allowance **and** the Married Couples Allowance for age 75 and over;
- T applies in most other cases
- OT means that no allowances have been given to you
- BR is an instruction to your employer to deduct tax at the basic rate
- NT means that no tax will be deducted
- DO means that tax will be deducted at the higher rate
- K means that the taxpayer has negative allowances (because their taxable benefits exceed their allowances).

7.1.4 PAYE Tax Coding Notices

Tax Coding notices are usually sent out in January or February for the tax year starting in April.

The notice will itemise each of the allowances and the deductions that the Tax Office has taken into account when establishing your tax code. "Allowances" increase your tax-free income. "Deductions" decrease your tax-free income.

Figure 8 overleaf describes the items that might be on your tax coding notice.

Figure 8: Possible items on your Tax Coding Notice

Allowances	Deductions
Personal allowance	Allowance restriction
Married allowance	Pensions and state benefits
Blind person's allowance	Other pensions
Maintenance payments	Jobseeker's allowance
Job expenses	Incapacity benefit
Charity gifts relief (higher-rate relief on payments)	Taxable benefits
Personal pension relief (high-rate relief only)	Untaxed income
	Tax underpaid

Looking at a couple of these items in particular;

An "**allowance restriction**" is included where a tax allowance is given to you at a restricted tax rate, and not at your highest rate (such as maintenance payments or married couple allowance, where the tax relief is only 10%).

This is best illustrated by way of example.

> ***EXAMPLE***
>
> *Harry Jones pays £3,500 in maintenance each year to his wife, Sally. Harry is a basic rate taxpayer.*
>
> *Harry should therefore get tax relief of £350 on his maintenance payments (being 10% of £3,500).*
>
> *In order to achieve this, as he pays tax at the basic rate of 22%, he needs to be given a* ***net*** *tax allowance of £350 x 100/22, or £1,591.*
>
> *This is done by the following amounts being included on Harry's PAYE Coding Notice;*
>
> *- the full amount of maintenance payments is brought in as a "tax allowance" (£3,500); and*
> *- an "allowance restriction" of £1,909 is brought in as a "deduction".*
>
> *The overall effect of the two adjustments together is £1,591.*
>
> *As this amount is included in Harry's tax code, he will receive an extra £1,591 of tax-free income in the year, which will cause him to pay £350 less tax in the year (£1,591 x 22%).*

Tax underpaid is an adjustment to collect tax that you owe from the previous year. The amount that you will see on your Coding Notice is the amount which, when multiplied by your top rate of tax, equals the tax that needs to be collected.

> ***EXAMPLE***
>
> *Paul House underpaid tax by £350 in 2005/06 because his company car changed during the year. Paul is a higher rate taxpayer.*
>
> *Paul's Coding Notice for 2006/07 will show a deduction of £875, as this will cause Paul to pay £350 more tax (£875 x 40%) in the tax year.*

7.2 Check Your Tax Code

Check your tax code. If it is wrong, you will pay the wrong amount of tax. It's as simple as that.

TIP	Check your tax code		
SAVE	£100's	**EASE OF USE**	OK
What you need to do	Get a copy of your Notice of Tax Coding (as sent to you by your Tax Office before the start of the tax year) and check the items listed on it. Use the explanation above to check your tax code.		

7.2.1 Check Inland Revenue "estimates"

If your code includes an allowance for an item on which you get tax relief (such as pension contributions) or a deduction for income that is not taxed at source (such as interest), your Tax Office will have made **an estimate** of how much that item will be **in the next tax year**.

This estimate will be based on information included in your last Tax Return or information provided by your employer.

When you check your code, pay particularly close attention to amounts that the Revenue have estimated. If the estimates are wrong, you will pay the wrong amount of tax.

TIP	Check the accuracy of the estimates that the Revenue have used in arriving at your tax code		
SAVE	£100's	**EASE OF USE**	OK

7.2.2 Keep the Revenue informed of your circumstances

Your code will only be correct if the Tax Office is **kept informed** of;

- all the changes in your personal circumstances that have an effect on your tax allowances, and
- the taxable benefits that you receive from your employer.

You should be particularly keen to inform the Revenue of any changes that will **increase** your tax code, for example;

- A reduction in the benefits that you receive from your employer,
- A significant reduction in the earnings that you receive from your employment,
- Your 65th and 75th birthday, or
- Your getting married if you are over 65.

An increase in your tax code will lead to an increase in your take home pay.

The sooner that you tell your Tax Office about such changes, the sooner they will issue a "Change of Tax Coding" notice to your employer, and the quicker you will receive a higher net salary.

What this means for you, will depend upon whether you complete a Tax Return or not;

- If you **do not** complete a Tax Return, this will save you tax;

- If you **do** complete a Tax Return, this will turn a tax rebate (that you will receive after you have submitted your Tax Return after the end of the tax year) into higher net salary during the tax year.

TIP	Inform your Tax Office of changes in your circumstances that will change your tax code		
SAVE	£100's	**EASE OF USE**	OK
What you need to do	Contact your Tax Office		

7.2.3 Avoid the emergency code

If your employer does not know what your tax code is, you will be taxed using something called the "emergency code".

Unless this is your first job, this will cause you to not benefit from your full tax-free allowance for the tax year **until** you submit your Tax Return.

TIP	Avoid the emergency PAYE code		
SAVE	£100's	**EASE OF USE**	OK
What you need to do	Get your old employer to give you your Form P45 when you leave your job, and pass it on to your new employer ASAP.		

7.3 Check your Income Tax deductions

You should always check that your employer is deducting the right tax from your salary. You can calculate what your income tax deduction should be by;

- Multiplying the "number" in your tax code by 10,
- Deducting the resulting number from your annual salary,
- Using the tax bands given in Figure 2 in Section 2 to calculate your annual tax bill,
- Divide the answer by 52 if you are paid weekly, or 12 if you are paid monthly

EXAMPLE

Harry Jones earns £23,000 per annum from his job. He is issued with a tax code of 185L for the year 2006/07. In 2006/07, Harry will pay the following tax;

Salary	*23,000*
Less: Tax-free income (185 x 10)	*(1,850)*
Tax worked out on an income of	*21,150*
Income Tax payable:	
On first £2,150 @ 10%	*215.00*
£2,150 to £21,150 @ 22%	*4,180.00*
Total tax payable	***4,395.00***

Harry should be paying £84.52 in income tax per week, calculated as follows;

£4,395.00 divided by 52	*84.52*

Alternatively, if he is paid monthly, his monthly tax bill will be £366.25;

£4,395.00 divided by 12	*366.25*

Warning: This calculation may not give you the "right" answer if your salary or your tax code has changed during the tax year.

If your calculation does not agree to the income tax figure that you pay by deduction from your salary, you should ask your employer to show you how your income tax been calculated and compare this to your own calculation.

If you have access to the internet, there are a number of free "payslip checkers" that you can use to perform this calculation for you. Just type "payslip checker" into any Search Engine.

TIP	Check your income tax deduction		
SAVE	£100's	**EASE OF USE**	OK
What you need to do	Use the explanation and example above to check your income tax deduction Speak to your employer about how they calculated your income tax if your calculation does not agree with the amount that has been deducted from your salary		

7.4 Check your National Insurance Contributions

National Insurance contributions (NICs) and how they are charged is explained in 2.12.

Refer back to Section 2 if you cannot remember how they are calculated.

There are some important points to make about NICs;

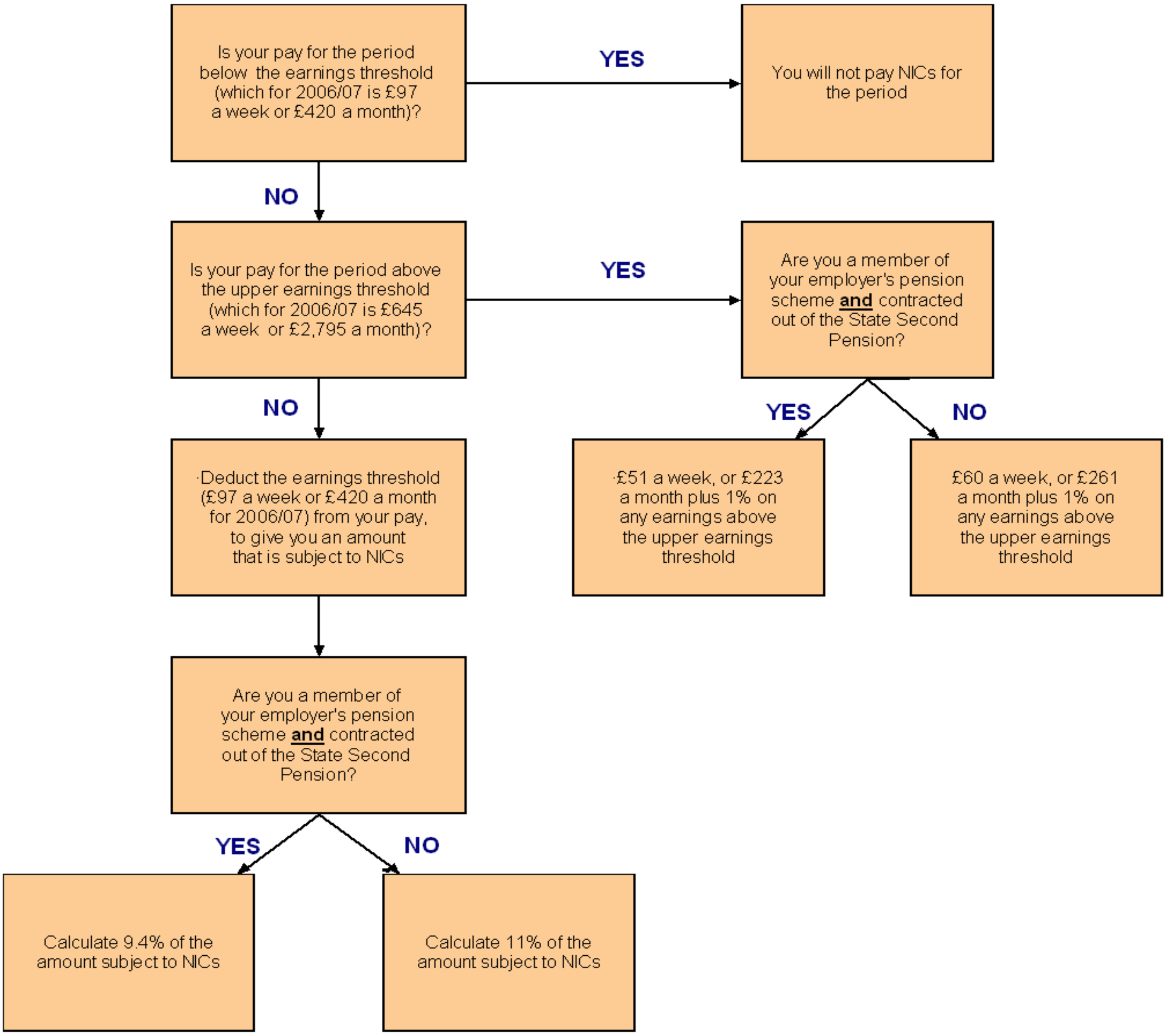
- Firstly, they are unaffected by your PAYE code – NICs are calculated on your gross income. As such, you **do not pay NICs** on any **taxable benefits**, nor do you get a deduction for any pension contributions that you make.

- Secondly, NICs are calculated on a **period-by-period basis**, which is unlike income tax. This means that each of your pay periods (e.g. week or month) is treated separately for NIC purposes and the earnings thresholds for Class 1 NICs are applied to each period.

> ***ILLUSTRATION***
>
> *If you are paid monthly and you earn less than £420 (being £97 per week) in June 2006, you **will not** pay Class 1 contributions for that month. If you earn more than £420 in July 2006, you **will pay** Class 1 NICs for that month. You **do not** carry any unused amount forward from June to July.*

You should check the calculation of your NICs each month as detailed on your payslip.

In order to do this, follow the steps set out in the diagram overleaf.



These steps will calculate your NICs unless you are claiming a deferral of NICs because you have more than one job. This is discussed in more detail in 7.6.2 below.

TIP	Check your national insurance contributions		
SAVE	£1,000's	**EASE OF USE**	OK
What you need to do	Use the explanation and example above to check the NICs deducted from your salary.		

7.5 Check your Form P60

Your employer **must** provide you with a Form P60 by 31st May following the end of the tax year. The Form P60 is a summary of the amount that you have earned from your employment, and the deductions that have been made from your earnings by your employer, in the tax year.

A copy of the Form is sent to the Inland Revenue, so it is very important that it is correct.

It is not uncommon for mistakes to be made in the production of these Forms, so check yours by calculating a total for the tax year for;

- gross pay,
- income tax, and
- national insurance contributions

from your weekly or monthly payslips, and comparing the answers to your Form P60.

You must keep the Form P60 in a safe place.

TIP	Check your Form P60		
SAVE	£100's	**EASE OF USE**	OK
What you need to do	Check the details on your P60 back to your payslips		

7.6 Multiple jobs

If you have two (or more) jobs, there are two important tax saving points that you need to consider.

7.6.1 Use all your allowances

You will get a separate PAYE code for each job, but your tax allowances will be included in the PAYE code that you are given for your main source of income.

If you do not earn enough income from your main job to use up your tax allowances, this will cause you to pay too much tax on your total earnings.

To prevent this, you should estimate whether the income from your main job is going to be sufficient over the course of a tax year to use up your tax allowances.

If it is not, and you are going to have unused, or "excess", tax allowances, you should ask the Revenue to allocate this excess to the PAYE code for your second job.

TIP	Share your tax allowances across two or more jobs		
SAVE	£100's	**EASE OF USE**	OK
What you need to do	Contact your Tax Office and ask them to allocate your tax allowances to more than one job.		

7.6.2 Defer National Insurance Contributions

If you have two (or more) jobs, you will need to be careful that you do not pay too much in the way of National Contributions.

As mentioned previously, there is a maximum annual earnings threshold for NICs (which is £645 a week in 06/07 and £630 for 05/06), which means that you should not pay NICs on any earnings above this amount.

This is easy to calculate and control if you only have one job. However, if you have two or more jobs, the picture gets a little more complicated.

For example, if you earn less than the NICs threshold in each of two jobs, your employers will deduct NICs at the full rate from your salaries. However, if your total annual earnings from both jobs is more than the NICs threshold, this means that you will have overpaid NICs.

If you expect to earn more than the NICs threshold over the course of year, but your income is spread across two jobs (or more), you should ask the Revenue to defer collecting NICs on your second job.

TIP	Don't overpay NICs.		
SAVE	£1,000's	**EASE OF USE**	OK
What you need to do	Speak to your Tax Office and ask them to defer collection of NICs in respect of your second job.		

7.7 Fringe benefits

"Fringe benefits" (sometimes also called "benefits in kind" or "perks") are benefits that;

- are provided to an employee in addition to his/her salary; and
- are paid for by his/her employer.

In most cases, fringe benefits are taxable. The amount that is taxable is called the "taxable benefit".

The Inland Revenue has a number of rules for calculating the taxable benefit for a wide variety of fringe benefits. Figure 9 below summarises the position for the most common forms of fringe benefit.

Figure 9. A summary of fringe benefits

Benefit	Taxable value	Taxable value if you are a "lower paid" employee (see 7.12.2)
Company cars	Up to 35% of the list price (see 7.9)	Tax-free
Free fuel	Up to £5,040 (see 7.10)	Tax-free
Company vans	£500, or £350 if 4 or more years old (but see below for future changes)	Tax-free
Cheap goods	The higher of (i) the second-hand value; or (ii) the cost to your employer of the goods	Second-hand value
Cheap services	The cost to your employer of providing the services	Tax-free
Living accommodation	Tax-free if it is necessary for you to live in the accommodation to do your job properly. Otherwise, there are special rules which must be followed to calculate the benefit	There are special rules which must be followed to calculate the benefit
Loan of goods	20% of value, or rent paid by the employer if this is higher	Tax-free
Loan of money	Interest saved (but only if loans are more than £5,000)	Tax-free
Private medical insurance	Cost to your employer	Tax-free
Relocation expenses	The first £8,000 is tax-free. Otherwise, taxed (see 7.13)	The first £8,000 is tax-free. Otherwise, taxed (see 7.13)
Credit cards	Amount spent, unless the item is tax-free (see list in 7.14) or the item is an allowable business expense	Amount spent, unless the item is tax-free (see list in 7.14) or the item is an allowable business expense

The total of your taxable benefits for a tax year is taken into account when calculating your tax code.

Future change: It is worth noting a significant proposed change to the way in which company vans are taxed. Currently, van drivers whose private travel is permitted to go beyond just home to work travel are taxed on a benefit of £500 (or £350 if the van is more than 4 years old), to cover the van and fuel. From 6 April 2007, the driver will be taxed on **£3,000** for the use of the van and **£500** if the employer provides fuel.

EXAMPLE

Joanna Taylor is 38 and she is married with 2 children. Her employer provides her with taxable benefits to a value of £2,405 in 2005/06. Joanna's tax code is calculated as follows;

Personal allowance	*4,895*
Taxable benefits	*(2,405)*
	2,490

Her tax code number will be 249 (being £2,490 divided by 10) and her tax code letter will be "L" (indicating that she receives the basic personal allowance).

Because your taxable benefits are included in your tax code, you will effectively pay tax on them throughout the tax year.

In terms of reducing your tax bill, you should always consider taking fringe benefits, such as a company car, as opposed to a salary increase, as they can be more a tax-efficient way of being paid.

The calculation that you need to do is relatively simple – all you are trying to do is compare your cash position with and without the benefit.

Lets illustrate this by way of example;

EXAMPLE

Andrew Harding earns £24,750 a year. Andrew is offered the choice of getting a company car worth £12,000 or having a salary increase of £2,000 a year.

Andrew currently pays costs of £300 a month for his own car – including lease payments, car tax and insurance.

Salary option

After deducting income tax and national insurance contributions, the salary increase is worth £1,340 a year in net earnings to Andrew.

Car option

If Andrew chose a company car worth £12,000, with a CO2 emissions level of 180 g/km, the taxable benefit on his company car would be 20% of £12,000 = £2,400[6]. Andrew would pay tax on this benefit at the rate of 22%, giving an additional tax liability of £528. Andrew would also save £3,600 a year in not having to pay costs for his own car.

Overall

As we can see below, the company car option would be better for Andrew;

Salary option	*£1,340 a year better off*
Car option	*£3,072 a year better off*

TIP	Consider taking fringe benefits instead of salary		
SAVE	£1,000's	**EASE OF USE**	OK
What you need to do	Calculate whether you will be better, or worse, off after tax by taking benefits rather than salary		

7.7.1 "Lower-paid' Employees

[6] The method by which the taxable benefit on company cars is calculated is explained in 7.9.

An employee who is paid at a rate of less than £8,500 per year **including the value of all benefits and reimbursed expenses** is a "lower paid" employee. A director of a company cannot be a "lower paid" employee.

"Lower paid" employees **do not pay tax** on fringe benefits.

There are 2 important points that you need to understand about this rule;

- In order to work out whether someone is a lower paid employee, you need to calculate the taxable benefit of his or her fringe benefits ***as if they were not a lower paid employee***, and then add this to the employee's salary. If this total is greater than £8,500, the fringe benefits will be taxed. If the total is less than £8, 500, the fringe benefits will not be taxed.

- The limit of £8,500 is reduced to reflect the amount of the time that the person has worked in the year. If the person only works for the last three months in a tax year and earns £3,000 in this time, his/her limit is £2,125 (being ¼ of £8,500) and, as such, any fringe benefits that the person receives over this period will be taxable.

TIP	If you are a "lower paid" employee; • Fringe benefits are a very tax effective way of getting paid, • Don't make the mistake of declaring a taxable benefit for such benefits		
SAVE	£100's	**EASE OF USE**	Simple

7.8 Computer equipment

Up until 5 April 2006, an employee was allowed private use of employer-provided computer equipment up to a total value of £2,500 (inclusive of VAT), (or that costs his employer up to £500 per annum in leasing costs), before he or she was treated as receiving a "taxable benefit".

Computer equipment included scanners, printers, modems and software.

A taxable benefit arose on the employee in respect of any value or lease cost over these levels. The taxable benefit was calculated as being 20% of any value over £2,500 and 100% of any lease cost over £500.

EXAMPLE

Euan Carlisle's employer provided him with a portable computer and other equipment to a value of £3,300 to enable him to work efficiently from home. The laptop is available for private use.

The taxable benefit on Euan was £160, being 20% of £800 (which is the excess over £2,500). If Euan was a basic rate taxpayer, he would have paid tax of £35.20 a year on this benefit.

Unfortunately, this exemption has recently been withdrawn, such that from 6 April 2006 onwards a taxable benefit will arise on an employee if he is provided with computer equipment by an employer **after** 5 April 2006 and this equipment is available for private use. The taxable gain is calculated as 20% of the cost of the equipment (or 100% of the lease cost paid by the employer).

HOWEVER: Anybody who has had a computer made available for private use **before** 6 April 2006 will **not** be affected by the change, and will therefore not be taxed on their personal use of such computer equipment.

Also, if an employee entered into an ***arrangement*** with their employer before 6 April 2006, and under that arrangement the employer is committed to provide a computer to the employee, but for reasons beyond their control the employee did not take physical possession of the computer until 6 April or later, the tax exemption will apply to the provision of that computer.

TIP	Do not pay tax on computer equipment if you were entitled to use it before 6 April 2006.		
SAVE	£100's	**EASE OF USE**	Simple
What you need to do	Provide documentary proof of your use of computer equipment before 6 April 2006, or of your *entitlement* to use such equipment before this date.		

7.9 Company cars

There are a number of tax saving Tips relating to Company Cars but, before explaining them, let us firstly explain how the taxable benefit of a Company Car is calculated.

For cars with a petrol engine with an approved CO^2 (Carbon Dioxide) emissions figure, the taxable benefit builds up from 15% of the car's list price in 1% steps, dependent upon the level of emissions, up to a maximum of 35%. Diesel cars may have a small additional percentage added, depending upon their emission level.

Figure 10 overleaf shows the taxable benefit for company cars (along with the taxable benefit the arises if your employer pays for all of your fuel).

EXAMPLE

Geoffrey Cooke earns £45,000 a year and he currently drives a 3.3 litre, petrol-engined, Chrysler Voyager which cost his employer £23,500 in 2003.

The Voyager has a CO2 emissions figure of 319 g/km, which means that Geoffrey's taxable benefit will be 35% of its list price, or £10,325.

As a higher rate taxpayer, Geoffrey will therefore pay £4,130 of tax on this car (being £10,325 x 40%).

If Geoffrey changed his car to a Volkswagen Touran (at a cost of £18,500 and with an emissions figure of 160 g/km) Geoffrey's taxable benefit would reduce to 18% of £18,500, or £3,330. On this, Geoffrey would pay tax of £1,332 – a tax saving of ***nearly £3,000.***

We recognise that the decision about which car you should buy is often a very personal and emotive one. As such, we are certainly not suggesting that you should select a Skoda instead of that Porsche 911 that you've always lusted after, just because it will save you over £7,500 of tax a year. However, ***we do suggest*** that you calculate the taxable benefit for each car on your "short-list" – as the tax bill could vary significantly from one car to another and a low tax bill may make one car more attractive than another!

Figure 10: Taxable benefits of company cars

	% of list price that is taxed		Taxable benefit of private fuel	
CO2 emission	Petrol	Diesel	Petrol	Diesel
145	15	18	2160	2592
150	16	19	2304	2736
155	17	20	2448	2880
160	18	21	2592	3024
165	19	22	2736	3168
170	20	23	2880	3312
175	21	24	3024	3456
180	22	25	3168	3600
185	23	26	3312	3744
190	24	27	3456	3888
195	25	28	3600	4032
200	26	29	3744	4176
205	27	30	3888	4320
210	28	31	4032	4464
215	29	32	4176	4608
220	30	33	4320	4752
225	31	34	4464	4896
230	32	35	4608	5040
235	33	35	4752	5040
240	34	35	4896	5040
245	35	35	5040	5040

Note: Cars that do not have an approved CO2 emissions figure are taxed according to their engine size.

Note: The differential of 20% in the taxable benefit between the cars with the lowest emissions figures and those with the highest (i.e. between 15% and 35%) is significant, especially for those employees who are higher rate taxpayers.

A useful approximate guide is that, for every £1,000 that your car costs;

- a basic rate taxpayer will pay an extra £2.20p in tax per year for every extra 5 g/km in CO2 emission up to the maximum emission level of 245 g/km;

- a higher rate taxpayer will pay an extra £4.00 in tax per year for every extra 5 g/km in CO2 emissions up to the maximum emission level of 245 g/km.

EXAMPLE

Tony Cooke, who is a basic rate taxpayer, is trying to choose between 3 cars that each cost £20,000; the first has an emission level of 150 g/km, the second has an emission level of 210 g/km and the third has an emission level of 270 g/km.

Tony knows a little about the taxation of company cars, and he knows that Car 1 will be cheapest from a tax perspective as it has a lower emission level than the other two. He wants to know how much extra tax he will pay if he chooses car 2 or 3 instead of car 1.

Using the "approximate guide" explained above, he can work out that this extra tax as follows.

***Car 2**:*

Extra tax payable = $\frac{20{,}000}{1{,}000} \times 2.20 \times \frac{(210 - 150)}{5}$ *= £528 extra tax/year compared to Car 1*

***Car 3**:*

Extra tax payable = $\frac{20{,}000}{1{,}000} \times 2.20 \times \frac{(245 - 150)}{5}$ *= £836 extra tax/year compared to Car 1*

TIP	Look to buy a company car with a low CO2 emissions level		
SAVE	£1,000's	**EASE OF USE**	OK
What you need to do	Find out the CO2 emissions levels of the car that you drive and the other cars that you would consider driving Calculate the tax that you are paying on your current car and the tax that you would pay on your alternative cars (given their list price and emission levels) Compare the tax charges and decide if there is a better value-for-money choice than the car you are currently driving		

The taxable benefit percentage is reduced for low emission vehicles;

- By 2% for bi-fuel LPG ad petrol cars
- By 3% for hybrid electrical and petrol cars
- By 6% for electric-only cars.

TIP	Save tax by buying a car that runs on alternative fuels		
SAVE	£1,000's	**EASE OF USE**	OK

Future change: It is worth noting that the taxable benefit for cars with an emission level of 120 g/km or less will be only **10%** from 6 April 2008 onwards.

7.10 Fuel benefit

You are treated as receiving a taxable benefit if your employer pays for your private petrol.

The amount of this taxable benefit depends upon two factors;

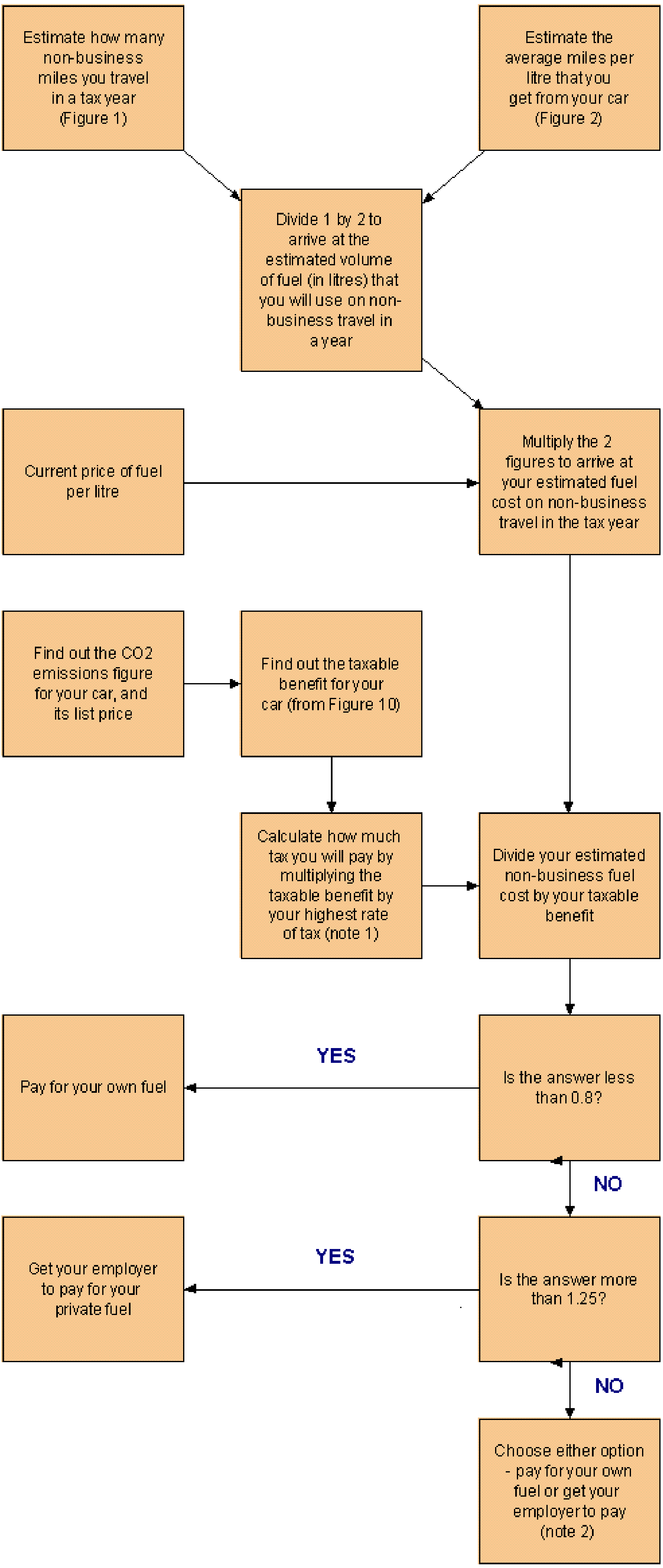
- the CO2 emission level of your car and, but to a lesser extent,
- whether the car runs on petrol or diesel fuel.

The exact amount of the taxable benefit is shown in Figure 10 above.

This taxable benefit will add between £475 to £1,109 to the annual tax bill for a basic rate taxpayer and between £864 to £2,016 to the annual tax bill for a higher rate taxpayer.

As a general point, it is normally much more tax-efficient to negotiate an increase in your remuneration package in return for giving up the right to free private fuel.

You can do a quick calculation to assess whether it is worth paying for your own petrol. This is illustrated by the diagram overleaf.


Estimate how many non-business miles you travel in a tax year (Figure 1)
Estimate the average miles per litre that you get from your car (Figure 2)
Divide 1 by 2 to arrive at the estimated volume of fuel (in litres) that you will use on non-business travel in a year
Current price of fuel per litre
Multiply the 2 figures to arrive at your estimated fuel cost on non-business travel in the tax year
Find out the CO2 emissions figure for your car, and its list price
Find out the taxable benefit for your car (from Figure 10)
Calculate how much tax you will pay by multiplying the taxable benefit by your highest rate of tax (note 1)
Divide your estimated non-business fuel cost by your taxable benefit
Pay for your own fuel
YES
Is the answer less than 0.8?
NO
Get your employer to pay for your private fuel
YES
Is the answer more than 1.25?
NO
Choose either option - pay for your own fuel or get your employer to pay (note 2)

Note 1: Your appropriate rate of tax is determined by adding the taxable benefit to your other taxable income in the year and seeing which income tax band the benefit falls into.

ILLUSTRATION.

If you have a taxable benefit of £4,032 in 2005/06 and other taxable income (after deducting allowances and reliefs) of £29,400, £3,000 of the benefit will be taxed at a rate of 22% and the remaining £1,032 will be taxed at a rate of 40%. (In 2005/06, the higher rate tax (40%) is applied to all taxable income above £32,400).

Note 2: If the result is between 0.8 and 1.25, the outcome is not sufficiently in favour of either choice to recommend one option over the other, given the degree of estimation in the calculation. As a result, you can choose either option.

TIP	Calculate whether you are better off paying for your own petrol and saving on tax.		
SAVE	£1,000's	**EASE OF USE**	OK
What you need to do	Follow the process described in the flowchart above		

7.11 "Pool" cars

There is no taxable benefit on an employee if he/she uses a "pool" car and any private use of the car is incidental to business use.

A "pool" car is one that is available to, and is used by, more than one employee for business use and it is not normally kept overnight at or near an employee's home.

It is worth considering a salary increase rather than a company car if you do not have any real need of a car for private use and can gain access to "pool" cars when you require one for business purposes.

TIP	Use a "pool" car for business purposes and don't pay any tax		
SAVE	£100's	**EASE OF USE**	Simple

7.12 Tax free car benefits

7.12.1 Car Parking

The provision of a car parking space either at or near an employee's place of work is not a taxable benefit.

If you drive to work, you could consider asking your employer for a car parking space instead of a salary increase, as;

- You will save on car parking charges <u>and</u> you will not be taxed on the benefit, and
- Your employer will not pay National Insurance contributions on the benefit.

TIP	Make use of a car parking space without paying tax		
SAVE	£100's	**EASE OF USE**	Child's Play

7.12.2 "Lower-paid' Employees

"Lower paid" employees **do not have any taxable benefit** arising from the provision of a company car, or from the purchase of fuel by his/her employer. This issue is discussed in more detail in 7.7.1 above.

TIP	If you are a "lower paid" employee; • a company car, and company-provided fuel, is a very tax effective way of getting paid, • don't make the mistake of declaring a taxable benefit for your company car and any company-provided fuel		
SAVE	£100's	**EASE OF USE**	Simple

7.13 Relocation expenses

If you have to move house because you have found a new job, or maybe because you have a new role within the company that you already work for, your employer may agree to pay for some of the costs of your move ("relocation expenses")**.** If this is the case, you need to be aware that **you will be taxed** on certain relocation expenses that are paid by your employer.

There are two different types of relocation expenses – "non-eligible" and "eligible" expenses.

You will pay tax on **all "non eligible" expenses** that are paid on your behalf by your employer. They include;

- Amounts paid to you by your employer to "subsidise" the costs of the mortgage on your new home,
- Any payment towards the costs of the mortgage on your old home,
- The costs of joining new clubs (health clubs, golf clubs etc);
- Losses on partly used season tickets,
- Any loss on the sale of your old home,
- Penalties and charges from organisations (e.g. schools) for giving late notice of contractual termination

And then there are **"eligible" expenses**. At the risk of sounding a little like Humphrey from "Yes, Minister", the best way to explain them is to say that any expenses that are not "non-eligible" are "eligible". They therefore include stamp duties, removal costs, legal fees and estate agent fees. **You will be taxed** on the **excess of any eligible relocation expenses** paid by your employer **over £8,000**.

If your employer is paying a fixed sum towards your relocation costs, you would be well advised to confirm with your employer that this payment relates to eligible expenses.

If you are going to pay tax on relocation expenses, you may want to negotiate with your employer to receive a guaranteed bonus – the bonus being calculated so that the net (after-tax) amount will pay for the tax that you have to pay on your relocation expenses and being timed so that it is received just before this tax is payable.

TIP	Be aware of your tax liability if you receive reimbursement for removal expenses		
SAVE:	£1,000's	**EASE OF USE**	Simple
What you need to do	Before you are committed to the relocation; • assess whether you are going to exceed the "eligible expense" limit of £8,000 • calculate any tax that you are going to have to pay on eligible and non eligible expenses • negotiate with your employer to see if they will make any contribution to your tax bill • plan how you are going to save money to pay your tax bill		

7.14 21 tax-free benefits

Here are 21 benefits that employers can provide to their employees **without the employee paying any tax**. As such, they will not be included on your Form P11D;

- **Staff Parties** - up to £150 per head (including staff spouse/partners)
- **Child Care** – in 2006/07 employers can contribute up to £55 per week towards approved childcare. Also, employer-provided nurseries do not create any tax liability on the employee,
- **Mobile Phones** – if the contract is in the name of the employer not the employee (**subject to a limit of one phone per employee**)
- **Long-service awards -** goods valued up to £50 for every year of service. The award must be made to mark a period of not less than 20 years service with the same employer
- **Loans** – interest free loans of up to £5,000
- **Meals** - Meals that are provided from a staff canteen and are provided to all staff
- **Taxis** – If you are working late, after 9pm, your employer can meet the cost of a taxi or other appropriate transport between work and home
- **Bicycles** – An employer can give an employee a bicycle and/or cycle safety equipment and this is tax-free if all staff are treated the same and the bicycle is used mainly for home to work journeys
- **Buses** – works' buses, minibuses or subsidies to use public bus services
- **Medical Insurance** – Insurance cover for employees working abroad
- **Working away from home** – if an employee is working away from their normal place of employment, with the expectation that they will resume employment at their normal place of work within a year, the employer can pay them for their home to work travel expenses, and overnight accommodation, without the employee paying any tax
- **"No additional cost" services** – if you receive services from your employer which are regularly offered to your employer's customers and your employer incurs no additional cost in providing these services to you, you will not be taxed on the benefit that you receive. A common example of this is flights offered to employees of British Airways
- **Medical check-ups**. Routine checks or screenings paid for by an employer are not taxable
- **Meal vouchers** – hardly worth it these days, but your employer can provide you with vouchers up to a value of 15p per day. When it began, this allowance was enough to buy a two-course meal!
- **Sports facilities** – there is no tax benefit on the employee for the provision of any sports or recreational facilities that are available to all staff
- **Incidental expenses on business trips** – reimbursement for incidental personal expenses up to an average of £5 for every night spent away from home in the UK and an average of £10 for every night spent overseas
- **Liability insurance** – directors' and employees' liability insurance paid for by your employer
- **Training expenses** – there is no taxable benefit if your employer pays the cost of your training, provided you are under 21 when the course begins **or** you are acquiring new skills which you need for your job
- **Relocation expenses** – "eligible" expenses up to £8,000 (see 7.13 above).

- **Parking** – space for car, van, motorbike or bike within reasonable distance of the workplace (see 7.12.1 above)

- **Eye Tests and Glasses** – Employees using VDUs are entitled to have the cost of eye tests and glasses for VDU use paid for by their employers.

If you are given the choice of taking salary or benefits to the same gross value, you will be better off taking benefits **if** they are listed above. You will not pay tax on these benefits, whereas you will pay tax on your salary.

If you receive any of the benefits listed above, you should make sure that they are not included on your Form P11D.

TIP	Receive "tax-free" benefits		
SAVE	£100's	**EASE OF USE**	Simple
What you need to do	Make sure that your Form P11D does not include a taxable benefit for any of the items listed above		

7.15 Check your Form P11D

Form P11D is a summary of the taxable benefits that you have received from your employer in the tax year. Your employer must provide you with your Form P11D by 6th July (if applicable). A copy of this Form is also sent to the Inland Revenue, so it is very important that it is correct.

More mistakes are made on Form P11D's than any other Form produced by employers. It is very worthwhile checking your Form and asking your employer about any amounts that you do not understand. If your Form P11D overstates the value of the taxable benefits that you have received, you will pay too much tax.

Particular areas to check are;

- **Time Apportionment** - If you have only received a fringe benefit for part of the tax year, make sure that this is taken into account on your P11D.

> ***ILLUSTRATION***
>
> *If you only had a company car for 3 months (or one quarter) of the tax year, your taxable benefit should be the annual taxable benefit of the car divided by 4.*

- **Making Good** – If you pay a contribution towards the cost of an asset or other benefit, make sure that this contribution is deducted from the taxable benefit charge.

> ***ILLUSTRATION***
>
> *If you pay £100 a month towards the cost of a company car, your taxable benefit should be the annual taxable benefit of the car less £1,200.*

You must keep your P11D Form if you complete a Tax Return. Keep it in a safe place.

TIP	Check your Form P11D		
SAVE	£100's	**EASE OF USE**	Simple
What you need to do	Check the taxable benefits listed on your Form P11D. Did you receive them? Check the taxable value of these benefits using information and examples provided in this Guide (and talk to your Tax Office if necessary). If you do not agree with the information on the Form, speak to your employer.		

7.16 Dispensation items

If your employer has not included a benefit on your Form P11D, it may be covered by something called a "dispensation".

This is where your employer has an agreement with the Inland Revenue that items do not need to be shown on the Form P11D because they relate wholly to "business use".

Dispensations commonly cover items such as business expenses - for example, where employees incur business travel expenses and then reclaim them from the employer.

If benefits are ***incorrectly*** not included on your Form P11D (i.e. they are not covered by a dispensation), you will still be liable to pay the tax on these benefits, along with late payment interest and penalties.

If you are in any doubt, you should check the position with your employer.

TIP	Check that benefits not listed on your Form P11D are covered by "dispensations".		
SAVE	£100's	**EASE OF USE**	OK
What you need to do	Confirm with your employer that benefits that you have received and that are not listed on your Form P11D are covered by dispensations.		

7.17 Deductible business expenses

Generally speaking, you can only get a "tax deduction" for money that you have spent on "business expenses" **<u>if</u>** you can demonstrate that the costs have been incurred "**wholly, exclusively and necessarily**" for the purposes of your employment.

DEFINITION:

A "tax deduction" means a cost that is deducted from your income before calculating how much tax you have to pay. It therefore reduces the tax that you pay.

7.17.1 Expenses reimbursed by your employer

If your employer **has** reimbursed you for money that you have spent on business costs, and these amounts are listed on your Form P11D as a taxable benefit, you can **claim a tax deduction for these costs**. The fact that you can claim a tax deduction ensures that you are no worse off in tax terms – as the taxable benefit *increases* your taxable income, and the tax deduction *reduces* your taxable income by the same amount.

If reimbursed business expenses are listed on your Form P11D, you must remember to claim a deduction for these expenses on your Tax Return. If you do not, you will pay too much tax.

Many people forget to do this. It is a common error.

If your employer **has** reimbursed you for money that you have spent on business costs, but these amounts are **not** listed on your Form P11D as a taxable benefit (probably because your employer has a dispensation covering these items – see 7.16), you **cannot claim a tax deduction for these costs**.

TIP	Check your Form P11D for reimbursed business expenses and, where you can, claim a tax deduction on your Tax Return for these items.		
SAVE	£100's	**EASE OF USE**	Simple

What you need to do	Keep records of all "tax deductible" costs that have been reimbursed by your employer Check your Form P11D to see what costs are listed as a taxable benefit. For those costs that are listed as a taxable benefit on your Form P11D, claim a tax deduction for the costs that you incurred by filling in boxes 1.32 to 1.35 of the Employment pages your Tax Return.

7.17.2 Expenses not reimbursed by your employer

If your employer has not been prepared to reimburse you for money that you have spent on business costs, then the Inland Revenue are likely to take the view that the cost was incurred as a matter of choice rather than as a "necessity", and therefore **not allow** you to claim a tax deduction for the cost.

However, there are a limited number of business expenses that the Revenue **will** allow you to deduct from your income for tax purposes **even if they have not been reimbursed by your employer**. These are as follows;

- Costs of working from home (see 7.18)
- Home telephone costs (see 7.19)
- The cost of buying home equipment (see 7.20)
- The costs of using your own car (see 7.21)
- Home-to-work travel costs (see 7.22)
- Bicycle and motorcycle costs (see 7.23)
- Annual subscriptions to a professional body (linked to your skills or profession)
- Clothing and maintenance of tools – The Revenue has set "flat rates" for these expenses, which are set out in Appendix 3, however you may choose to claim a deduction for the actual expenditure that you incur if you would prefer;
- Insurance cover – payment by directors or employees for work-related insurance cover;

You can claim a tax deduction for these costs even if they have not been reimbursed by your employer.

TIP	Make sure that you claim a tax deduction for business expenses paid by you and not reimbursed by your employer as long as they fall into the categories listed above.		
SAVE	£100's	**EASE OF USE**	Simple
What you need to do	Keep records of all "tax deductible" costs Fill in details of these costs in boxes 1.32 to 1.35 of the Employment pages your Tax Return.		

Tips 7.18 to 7.25 relate to business costs that you can claim a tax deduction for even if they are not reimbursed by your employer.

7.18 Working From Home

7.18.1 Get your employer to confirm that you are required to work from home

If you are employed, but work some of the time from home, you may be able to claim some of your home's running costs as "business expenses" (and therefore be able to deduct them in calculating your taxable income).

However, it is much more difficult to claim a tax deduction for a proportion of your household expenses if you are employed rather than self-employed. (NB: The deduction for self-employed people is described in 8.10.1 below).

If you are *employed*, you will generally only be able to claim for a proportion of your household expenses when you have documentation from your employer (either a statement or specific terms written in your employment contract) confirming that it is a condition of your employment that you work from home. Here are some pointers as to what the Inland Revenue will be looking for in this documentation;

- You should be required to attend your employer's premises for 'up to whatever period is agreed', and not on specific occasions.

- Your attendance at your employer's premises should be 'for the purpose of conducting business meetings and having briefing meetings with colleagues', so that the attendance is for a limited and specific purpose.

- You should be required to set aside a room at home as a study, preferably with a lock on the door and with a locked filing cabinet, in order to protect client confidentiality. A provision should be made that the work not carried out at the employer's premises must be carried out in this room, and files must be stored in the locked filing cabinet when not in use.

- Your employer should provide you with a desktop computer (in preference to a laptop), and this computer should be insured for use only in the study.

- You should be required to be available on the home telephone number during working hours unless you are elsewhere on work-related business.

TIP	Get your employer to document that you are required to work from home for some of the time.		
SAVE	£100's	**EASE OF USE**	OK

7.18.2 Claim a proportion of your household expenses

Armed with the documentation described in 7.18.1, you can claim a tax deduction for certain household costs, however your claim is likely to be very restricted compared to that which you could make if you were self-employed.

As an employee, your claim is generally limited to;

- Specific costs that you incur as a direct result of your working from home, such as any extra insurance, cleaning or security costs, and

- A proportion of your home's heat and light costs, such proportion calculated using the following formula;

$$\frac{\text{number of rooms used for business purposes x percentage use of those rooms for business purposes}}{\text{number of rooms in the house}}$$

In calculating this proportion, you should exclude bathrooms, kitchens and toilets from the number of rooms in your house, but you should include the Garage if it stores tools or the vehicle that you use for your business/employment.

You ***cannot*** include standing charges in this calculation, nor can you include the cost of your council tax or water rates.

There are Capital Gains Tax implications of claiming a tax deduction for these costs. This is discussed in more detail in Section 19.

TIP	If you work from home, claim a tax deduction for a proportion of your household expenses.		
SAVE	£100's	**EASE OF USE**	OK
CONSIDER	If you do not take appropriate steps, part of the capital gain that you make on the sale of your house may be taxable if you claim a deduction for household expenses. See Section 19.		
What you need to do	Keep records of your household expenses Calculate the amount that you can claim as business expenses based on the proportion of rooms that you use for your business and the usage of those rooms. Include this amount in Box 1.35 of your Tax Return		

7.19 Home telephone costs

You can claim a tax deduction for the costs that you incur in making **business** telephone calls **from home**.

If you have a telephone line that is solely for business purposes, you can claim all the costs as a tax deduction (including rental and installation costs).

If you have one telephone line that you use for business and private purposes, you cannot claim any element of the rental or installation costs as a deduction. In this instance, you will need to keep a log of the time that you spend on business calls, so that you can apportion the cost of calls on your telephone bills between private and business use.

TIP	Claim a deduction for home telephone costs		
SAVE	£100's	**EASE OF USE**	OK
What you need to do	Keep all of your home telephone bills and a record of all of your business calls Calculate the cost of your business calls Claim a deduction for this cost in Box 1.35 of the Employment pages of your Tax Return		

7.20 Home equipment

If you buy an asset (such as a computer or furniture) that you **need** to enable you to work from home, you can claim a tax deduction for its cost.

This deduction is called a "**capital allowance**". If you do not know how capital allowances work, you should turn now to Appendix 5 and read our Guide to Capital Allowances.

For 2006/07, you get a capital allowance of 50% of the cost of the asset in the first tax year of ownership, and 25% of the "written down value" of the asset for each tax year after that. This applies to all assets, including furniture, computer and telecommunications equipment, lighting and machinery, **but <u>not</u> to cars** (see 7.21.4).

If you use the asset for private (as well as business) purposes, the tax deduction is reduced to reflect the amount of private usage as follows;

$$\text{Tax deduction} = \text{Capital allowance} \times \frac{\text{Business use}}{\text{Total use}}$$

You also need to be aware that your capital allowance for the first tax year of ownership is **not affected** by how long you owned the asset.

ILLUSTRATION

*You will be able to claim a capital allowance of 50% of the cost of a computer for 2006/07, whether you bought the computer on 6th April 200**6** or 5th April 200**7**.*

EXAMPLE

In June 2006, Mark Luddington buys a desk for £1,250 and a filing cabinet for £250, so that he can work from home. Mark uses the filing cabinet exclusively for his job, and he estimates 50% private usage of the desk. Mark will get a tax deduction of £250 for the desk and £100 for the filing cabinet in 2006/07, calculated as follows;

Desk:

50% "first year" allowance on the desk	*= £625 (£1,250 x 50%)*
Reduced by 50% private usage	*= £312.50 (£625 x 50%)*
Written down value carried forward to next tax year	*= £625 (£1,250 less £625)*

Filing cabinet:

50% "first year" allowance on cabinet	*= £125 (£250 x 50%)*
Written down value carried forward to next tax year	*= £125 (£250 less £125)*

In 2007/08, Mark will get a tax deduction of £109.37 (£78.12 for the desk and £31.25 for the filing cabinet).

TIP	Claim a tax deduction for equipment that you have bought to enable you to work from home		
SAVE	£1,000's	**EASE OF USE**	Simple
What you need to do	Keep invoices and other documents to prove the cost of assets that you use for the purposes of your job Estimate the amount of private usage Calculate your capital allowance in accordance with the rules outline above Claim a deduction for the capital allowance(s) in Box 1.35 of the Employment pages of the Tax Return		

7.21 Using your own car on company business

7.21.1 Tax Deduction

You can claim a tax deduction for the business mileage that you travel in your own car based on the Inland Revenue authorised mileage allowance payments ("AMAP rates"), as set out in Figure 11 below.

Figure 11: Authorised mileage rates for 2006/07 and 2005/06

Business miles	Rates
First 10,000 miles	40p per mile
Thereafter	25p per mile

These rates apply to each tax year. As such, you can claim a deduction of 40p per mile for the first 10,000 business miles that you travel in each and every tax year.

In order to calculate your tax deduction, you will therefore need to keep an accurate day-by-day record of your business mileage for each tax year (this should normally ***exclude*** everyday commuting from your home to your place of work – see 7.22 below).

If your employer reimburses you for your business mileage;

- And these reimbursements are **included** on your Form P11D, you can claim a tax deduction for your business mileage in accordance with Figure 11 above;

- And these reimbursements are **not included** on your Form P11D, you can only claim a tax deduction for the "net" amount, i.e. the difference between the tax deduction calculated in accordance with Figure 11 above and the amount reimbursed.

EXAMPLE

Mark Watson drove 11,000 miles during 2005/06, 5,000 of which was on business. Mark's employer pays him 13p per business mile. Mark can claim a deduction of £1,350 for the tax year, calculated as follows;

(5,000 x 40p) – (5,000 x 13p) = £1,350.

TIP	Claim a tax deduction for business mileage		
SAVE	£100's	**EASE OF USE**	OK
What you need to do	Keep records of business mileage. Keep records of what you have been reimbursed for these trips. Look at your Form P11D for the year. If your Form P11D includes business mileage reimbursements, calculate the full tax deduction using the AMAP rates. If your Form P11D does not include business mileage reimbursements, calculate the difference between the full tax deduction using the AMAP rates and the amount that you have been reimbursed by your employer. Claim a tax deduction for your mileage by putting the amount in Box 1.32 of the Employment pages of your Tax Return.		

7.21.2 Taxable benefit on the reimbursement of business mileage

If your employer reimburses you for your business mileage at a rate that is higher than the AMAP rates, you will pay tax on the excess.

You will need to keep careful track of your total business mileage in each tax year, particularly if you are reimbursed by your employer at a rate in excess of 25p per mile. This is because you will be taxed on all reimbursements once you have exceeded 10,000 business miles in a tax year.

If you are reimbursed for business mileage at rates higher than the AMAP rates, you should consider putting money aside out of each reimbursement to cover your year-end tax bill.

EXAMPLE

John Clancey, a higher rate taxpayer, did 23,500 business miles in 2005/06 in his own car. His employer reimburses him for business miles at a rate of 40p per mile.

The rate is in accordance with the AMAP rates for the first 10,000 miles, but after this he is receiving 15 per mile too much.

John is treated as receiving a taxable benefit of £2,025 (being 15p x 13,500 miles), on which he will pay tax of £810 (being 40% of £2,025).

It would have been worth John's while to put aside 15% of the business mileage payments received from his employer once he had exceeded 10,000 business miles, to cover his year-end tax bill.

TIP	Recognise that you will pay tax on any reimbursement by your employer in excess of the AMAP rates		
SAVE	£100's	**EASE OF USE**	OK
What you need to do	Keep track of your business mileage and put money aside out of your reimbursements to cover any potential tax bill		

7.21.3 Receive higher than normal reimbursement for mileage without paying tax

There is one instance when **you <u>can</u> be reimbursed by your employer at a rate above the AMAP rate, without incurring a tax charge.**

If you are the driver of a car, your employer can pay you an additional 5p per mile (over and above the AMAP rates) for each employee who travels with you on a business journey, without you incurring any tax charge.

This means that if, for example, you take 2 colleagues to a business meeting, you can be reimbursed by your employer at up to 50p per mile for that trip without incurring a tax charge.

However, you cannot claim **a tax deduction** for an amount higher than the AMAP rates **at any time**.

TIP	Ask your employer about being reimbursed in line with Revenue guidelines when you take colleagues on a business journey.

7.21.4 Capital allowances

Up until 2001/02 an employee was entitled to claim a capital allowance if he/she used his/her own car on business trips.

This practice is no longer permitted. Don't do it.

TIP	Don't claim a capital allowance for your car

7.22 Home-to-work travel costs

Normal home-to-work travel costs (e.g. the costs of commuting) are **not** deductible for tax purposes, **<u>unless</u>** the nature of your job **requires you** to carry out your duties at home. If you are based at home, you will be able to claim a tax deduction for the costs of home-to-work travel.

Area representatives and those holding part-time employments, such as consultants, should establish when they accept their employment that their place of employment is at their home, making their travelling expenses **from home** deductible for tax purposes.

The same principle applies here regarding employer reimbursements as it did in 7.21.1 above. So, if your employer reimburses you for your home-to-work travel costs;

- and these reimbursements are **included** on your Form P11D, you can claim a tax deduction for the costs that you have incurred on home-to-work travel;

- and these reimbursements are **not included** on your Form P11D, you can only claim a tax deduction for the "net" amount, i.e. the difference between the costs that you have incurred on home-to-work travel and the amount reimbursed.

TIP	Claim a tax deduction home-to-work travel costs if you are based at home.		
SAVE	£100's	**EASE OF USE**	Simple

There are special rules that apply to site-based workers, employees who cover geographical areas and employees who have more than one place of work. We discuss each of these, in turn, below.

7.22.1 Site-based workers

Employees who work at a number of different places for a few weeks or months at a time can claim a tax deduction for all of their home-to-work, **providing**;

- Initially, it must be expected that the job will last for less than 2 years, and the job must last for less than this,
- There is no requirement for an employee to return to his or her permanent workplace when each job comes to an end, and
- The employee only spends occasional (and incidental) periods off-site.

TIP	Get treated as a site-based worker and you will be able to claim a tax deduction for any home-to-work travel costs that you have incurred.		
SAVE	£100's	**EASE OF USE**	Simple
What you need to do	Make sure that you comply with the rules set out above		

7.22.2 Area-based employees

The geographical area covered by employees (such as salesmen) is treated as their permanent place of work.

As such;

- All costs of travelling ***within the area*** are deductible for tax purposes;
- If an employee lives outside the area, the costs of travelling from home to the start of the area is **not tax deductible**. However, it is quite possible for the whole of the UK to be "the area" if the employee services customers throughout the country. In this instance, all travel costs will be deductible.

TIP	If you work a geographic area, you can claim a tax deduction for any costs that you have incurred travelling within that area.		
SAVE	£100's	**EASE OF USE**	Simple
What you need to do	Try to include your home in the area that you cover, as this will allow you to claim a tax deduction for all of the travel costs that you incur.		

7.22.3 Employees with more than one place of work

An employee will be considered to have a permanent place of work if;

- The employee regularly performs more than 40% of his/her duties there, or
- Customers, suppliers or other people would expect to make contact with the employee there, or
- The employee has an office or desk and support services (e.g. secretary) there.

It is possible, therefore, that a person may have more than one permanent place of work.

If this is the case, the employee will not be able to claim a tax deduction for the costs of travelling from home to all of those places of work.

TIP	You will not be able to claim a deduction for travel costs to your permanent place(s) of work. You must take steps to ensure that you will not be treated as having more than one "permanent places of work".		
SAVE	£100's	**EASE OF USE**	Simple
What you need to do	Use the checklist above to minimise the number of places that are considered to be your "permanent places of work"		

As far as 7.22.1, 7.22.2 and 7.22.3 are concerned, you **will be taxed** on any **reimbursement** that you receive from your employer **if**;

- The **costs** that are being reimbursed **are not tax deductible**; **or**
- The amount of the reimbursement is more than the amount that is tax deductible (in which case you are taxed on the difference between the two)

ILLUSTRATIONS

If you are treated as being permanently based at a location for tax purposes, but your employer reimburses you for the costs of travelling to and from that location, the amount of the reimbursement is a taxable benefit.

*If you are a sales rep responsible for Kent, you live in Crawley in Sussex, and your employer reimburses you for **all** of your mileage, the amount that relates to your travel to and from Kent each day will be a taxable benefit.*

7.23 Bicycles and Motorcycles

In line with the Governments "green" policy, you are allowed to receive reimbursement from your employer for mileage on business travel undertaken on a Bicycle (at a rate of 20p per mile), or on a Motorcycle (at a rate of 24p per mile), without incurring any tax charge.

You can claim a tax deduction for any shortfall between the amount that you received from your employer and the amount that you were entitled to receive tax-free (using the rates set out in the previous paragraph).

I know that this isn't practical for most of us, but is worth bearing in mind, especially if you are a postman or a courier…

TIP	Use two wheels for business purposes and get a very generous tax deduction		
GET	£100's	**EASE OF USE**	Child's Play!
What you need to do	Keep records of your business mileage Calculate your tax deduction, by multiplying your business mileage by the approved rate and deducting any amounts reimbursed by your employer Put this amount in Box 1.32 of the Employment pages of your Tax Return		

7.24 The costs of dealing with enquiries from the Revenue

If the Revenue opens an investigation into your tax affairs, you can claim a tax deduction for any professional costs that you incur in dealing with their enquiries.

TIP	Claim a tax deduction for professional costs that you incur in dealing with enquiries from the Revenue		
SAVE	£100's	**EASE OF USE**	Simple

7.25 Loan interest

If you borrow money to either;

- buy shares in a private company (i.e. a company that is not listed on the Stock Exchange), or
- to lend on to a company,

and you either;

- own more than 5% of the company's shares, or
- you spend the greater part of your time working for the company,

then any interest that you pay on the loan is tax deductible.

TIP	Claim a deduction for interest		
SAVE	£1,000's		Simple
What you need to do	Keep records to show what the borrowed money was used for. Include the interest cost in Box 3.60 of your Tax Return		

7.26 Collecting an underpayment of tax

If;

- you are employed,
- you pay tax through PAYE,
- you complete a Tax Return,
- you submit your Tax Return before 30 September, **and**
- you owe less than £2,000 in tax,

the Inland Revenue will allow you to pay this tax gradually over the course of the following tax year. The Inland Revenue will adjust your tax coding to take account of the amount of tax that you owe, which will cause your "take home pay" during the following tax year to be reduced by the amount of tax that you owe.

Remember: In order to pay tax in this way, you need to submit your Tax Return to the Revenue **before 30 September**.

TIP	Take time to pay back an underpayment of tax
What you need to do	Get your Tax Return in by 30 September Don't tick box 23.1 on your Tax Return

7.27 Salary or dividend?

In overall tax terms, if you have your own company, it is generally better to take a low salary of around £7,500 (the minimum level that is acceptable given minimum wage legislation and that takes advantage of national insurance contribution thresholds) and the remainder by way of dividend.

Dividends are more tax-efficient. Lets illustrate this by way of example. The table below shows the total tax that is paid if a company's profit is fully distributed either by way of dividend or by way of salary.

Company Profit	10,000	15,000	20,000	30,000
Tax liability if paid by Dividends;				
Corporation Tax	1,900	2,850	3,800	5,700
Income Tax	0	0	0	0
Class 2 NI	0	0	0	0
Class 4 NI	0	0	0	0
Total Tax	1,900	2,850	3,800	5,700
Net Income	**8,100**	**12,150**	**16,200**	**24,300**
Tax liability if paid by Salary;				
Income Tax	710	1,685	2,660	4,611
Employee NI	484	971	1,459	2,434
Employers NI	563	1,130	1,698	2,832
Corporation Tax	0	0	0	0
Total Tax	1,757	3,788	5,818	9,878
Net Income	**8,243**	**11,212**	**14,182**	**20,122**
Benefit of dividend	**(143)**	**938**	**2,018**	**4,178**
Benefit of dividend (%)	**(1.7)%**	**8.4%**	**14.2%**	**20.7%**

As you can see, once you start to earn profits of more than £10,000 or so, dividends become a much more effective means of withdrawing money from your business.

In the past, when deciding whether to take salary or dividend, you have also had to bear in mind that the maximum amount that you could put tax-free into a pension in any one year was determined by your "Net Relevant Earnings" (see 18.3), and "Net Relevant Earnings" **included** salary but **excluded** dividends.

However, from 6 April 2006 onwards this is no longer the case (see 18.17 below).

TIP	You will save tax by taking a low salary and the rest of your income in dividends		
SAVE	£1,000's	**EASE OF USE**	OK
What you need to do	Plan in advance so that you take out the minimum level of salary that you need in order to use your allowances and take the rest of your money out by way of dividend.		

7.28 Employee Share Plans

Employee Share Plans are very tax effective ways of buying shares in the company that you work for. We summarise below the more common forms of Employee Share Plans.

7.28.1 The Share Incentive Plan

A Share Incentive Plan involves the setting up of a Trust that acquires shares in your employer with funds provided by your employer. The shares are “allocated” to eligible employees in accordance with the rules of the Share Incentive Plan.

Shares can be given (or “allocated”) to employees in four different ways;

Free Shares: These are shares given free of charge to each employee subject to a maximum value of £3,000 in any tax year. They are normally subject to a holding period of between 3 years and 5 years;

Partnership Shares: These are shares of up to £1,500 in value per tax year bought by employees from their pre-tax salary i.e. before tax and National Insurance Contributions (NICs), subject to a limit of the lower of 10% of salary or £125 per month;

Matching Shares: These are free shares given by employers for every partnership share in the company that an employee purchases. The maximum ratio is 2 Matching Shares to 1 Partnership Share;

Dividend Shares: These are shares that are bought by using the dividends that are received in respect of those shares that are already held in the Share Incentive Plan, subject to a maximum value of £1,500 per annum.

Tax Treatment

The income tax treatment depends on the length of time the shares remain in the Share Incentive Plan.

In general terms, shares held for:

- between 1 and 3 years are chargeable to income tax and National Insurance Contributions on the market value of the shares on the date they are removed from the Share Incentive Plan.

- between 3 and 5 years are chargeable to income tax and National Insurance Contributions on the **lower** of:

  (i) the market value at the date of “allocation”; and
  (ii) the market value at the date the shares are removed from the Share Incentive Plan.

- more than 5 years are not chargeable to income tax or National Insurance Contributions at all.

In terms of capital gains tax;

- There is **no capital gains tax** on any increase in the value of the shares while they are held in the Share Incentive Plan;

- Any increase in the value of the shares once they have been removed from the Share Incentive Plan **is taxable**, but the employee will be able to use his/her annual Capital Gains Tax allowance (£8,500 in 2005/06, £8,800 in 06/07) and claim Business Asset Taper Relief on these gains (which may enable the capital gains tax to be reduced to as low as 10% of the gain). Refer to Section 19 for an explanation of Capital Gains Tax and Business Taper Relief.

7.28.2 Enterprise Management Incentive scheme

Under an Enterprise Management Incentive (or “EMI”) scheme, an employee is given the right (or “option”) to purchase a stated number of shares in the company for which he/she works at a fixed price on, or after, a specified date in the future. The terms of the option are typically set out in an Option Agreement.

The EMI scheme is aimed at companies with gross assets worth £30 million, who are independent, trading in the UK and operating in a qualifying industry sector. Forestry, agriculture and finance are all **excluded** sectors.

The scheme is discretionary, so the company can grant options to as many employees as it wishes. However, the employee must work full time (at least 25 hours per week or spend at least 75% of their time working for the company) and must not control more than 30% of the ordinary share capital of the company.

The maximum value of options that can be granted by a company under an EMI scheme is £3 million, and each employee can hold options worth a maximum value of £100,000 in a three-year period.

Tax Treatment

No income tax or National Insurance Contributions are due at the time that the option is given to the employee.

Generally, no income tax or national insurance contributions are payable when the shares are purchased, as long as this is done in accordance with the terms of the Option Agreement.

When the shares are sold, capital gains tax will be payable (on the difference between the sale proceeds and the amounts paid for them), but the employee will be able to reduce the taxable gain by;

- claiming Business Asset Taper Relief for the period between when the option was given to the employee and when the shares were sold (which may enable the capital gains tax to be reduced to 10% of the gain); and

- using his/her annual Capital Gains Tax allowance (£8,500 in 05/06, £8,800 in 06/07).

7.28.3 Company Share Option Plan

Under a Company Share Option Plan, a company can give each employee options to buy its shares at a fixed price on, or after, a specified date in the future. This is a discretionary plan, thus the company is allowed to decide which employees join.

The employee is granted options at a price that must not be less than the market value of the shares on the date of when the option is granted. The option is valid for 10 years but cannot be exercised within the first 3 years.

The total value of options over shares under this scheme is limited to £30,000 per employee (calculated by multiplying the number of shares that the employee is entitled to buy by the price of the shares on the date that the option is given to the employee). Any grants that exceed this limit will automatically not attract tax relief.

Tax Treatment

The tax treatment of the share options given to employees is similar to those given under an Enterprise Management Incentive scheme (see above).

7.28.4 Save As You Earn (SAYE) Option Scheme

A SAYE Plan must be offered to all "qualifying" employees of a company. A qualifying employee is broadly defined as any employee or full-time director;

- employed for a continuous period not exceeding 5 years; and

- resident in the UK for tax purposes.

The "option" element of a Sharesave Plan is the same as the other schemes already described, in that each employee is given an option to buy company shares at a fixed price on, or after, a specified date in the future.

The difference with a Sharesave Plan is that each employee enters into a savings scheme at the time when the option is given to him/her (such that fixed amounts are set aside each month out of the employee's gross salary), and the proceeds of this savings scheme is then used to buy the shares under the terms of the share option.

Employees typically have their savings scheme with a UK bank or building society and make regular savings of a fixed sum (between £10 and £250 per month) for a specified period (i.e. 3 year or 5 years). The period of the savings scheme is normally chosen to coincide with the period of the share option.

At the end of the savings scheme;

- a cash bonus is paid tax-free;

- the employee chooses whether to use the proceeds of the savings scheme to buy the shares (under the terms of the option that was given previously). Any difference between the price paid for the shares (which is set in advance) and the value of the shares (being the market price of the shares n the date they are bought) is not subject to income tax.

When the shares are sold, the gain (which is calculated as the difference between the amount received for the shares and the amount paid for them) is subject to capital gains tax. However, this can be reduced by Business Asset Taper Relief and possibly eliminated altogether through prudent timing and use of the annual capital gains exemption (£8,500 for 2005/06, £8,800 in 2006/07).

7.28.5 Overall

There are significant tax benefits of buying and owning shares through an approved Employee Share Plan, however you **may** lose money if the price of the shares falls significantly.

EXAMPLE

Tony Pollitt, a higher rate taxpayer, saved £2,500 a year for each of the first 5 year's of his employment with Digger plc under the terms of the company's SAYE Plan.

At the end of this period, the balance on Tony's savings account was £13,500 (being £12,500 of salary contributions plus interest earned on these savings of £1,000).

On this date, Tony received a tax-free cash bonus of £500 and he bought 10,000 shares in Digger plc for £14,000 (the cost of £1.40 per share being defined in the terms of the Sharesave Plan). The share price at this time was £1.75. Tony sold all of his shares 12 months later for £20,000 (at a price of £2.00 a share).

Tony has a capital gain of £6,000, although his CGT allowance is £8,500 (for 20045/06), so no gain is taxable. Tony does not pay any income tax or national insurance contributions in connection with these transactions. Overall, therefore, Tony received £20,000 without paying any tax.

If Tony had not participated in the Sharesave Plan;

- *he would have received additional gross salary of £2,500 a year for 5 years, but he would have paid tax on this salary at a rate of 40% and he would have paid national insurance contributions at a rate of 1%. Therefore, he would have received additional net salary of £7,375 (being 59% of £12,500).*
- *he would have earned £590 in interest if he had invested this extra salary in a savings account for 5 years.*

*Therefore, had he not participated in the Sharesave Plan, Tony would have received £7,965. This is just over **£12,000 less** than he received from participating in the Sharesave Plan.*

*However, there are **two** reasons for this huge difference;*

- *the favourable tax treatment given to people who participate in such schemes; **and***
- *the increase in the value of Digger plc's shares.*

If the price of the shares fell, so that they were only worth 50p each when Tony came to sell them, he would receive a total of only £5,000 on the sale of his shares.

In this instance, the benefit provided by the preferential tax treatment is more than offset by the loss arising from the fall in value of Digger plc's shares. In this example, Tony would be nearly £3,000 worse off by participating in the Sharesave Plan.

It is very important to realise that there is always an element of risk in Employee Share Plans.

TIP	Give careful consideration to investing in your employer's shares via an Employee Share Plan.		
SAVE	£1,000's	**EASE OF USE**	OK

CONSIDER	There are attractive tax benefits of investing in this way, although whether it is ultimately worthwhile or not will depend upon what happens to the share price of your employer's shares.
What you need to do	Obtain information from your employer about any Share Plans that they operate. Read the information carefully so that you fully understand all of the risks as well as the tax benefits. If possible, speak to an employee who is already participating in the Plan to confirm how it works. Fill in the documentation provided by your employer.

7.29 Leaving a job

Payments that you get when you leave a job fall into three categories, "always taxable", "never taxable" and "taxable but with deductions", as shown in Figure 12 below.

Figure 12. Tax treatment of "leaving" payments

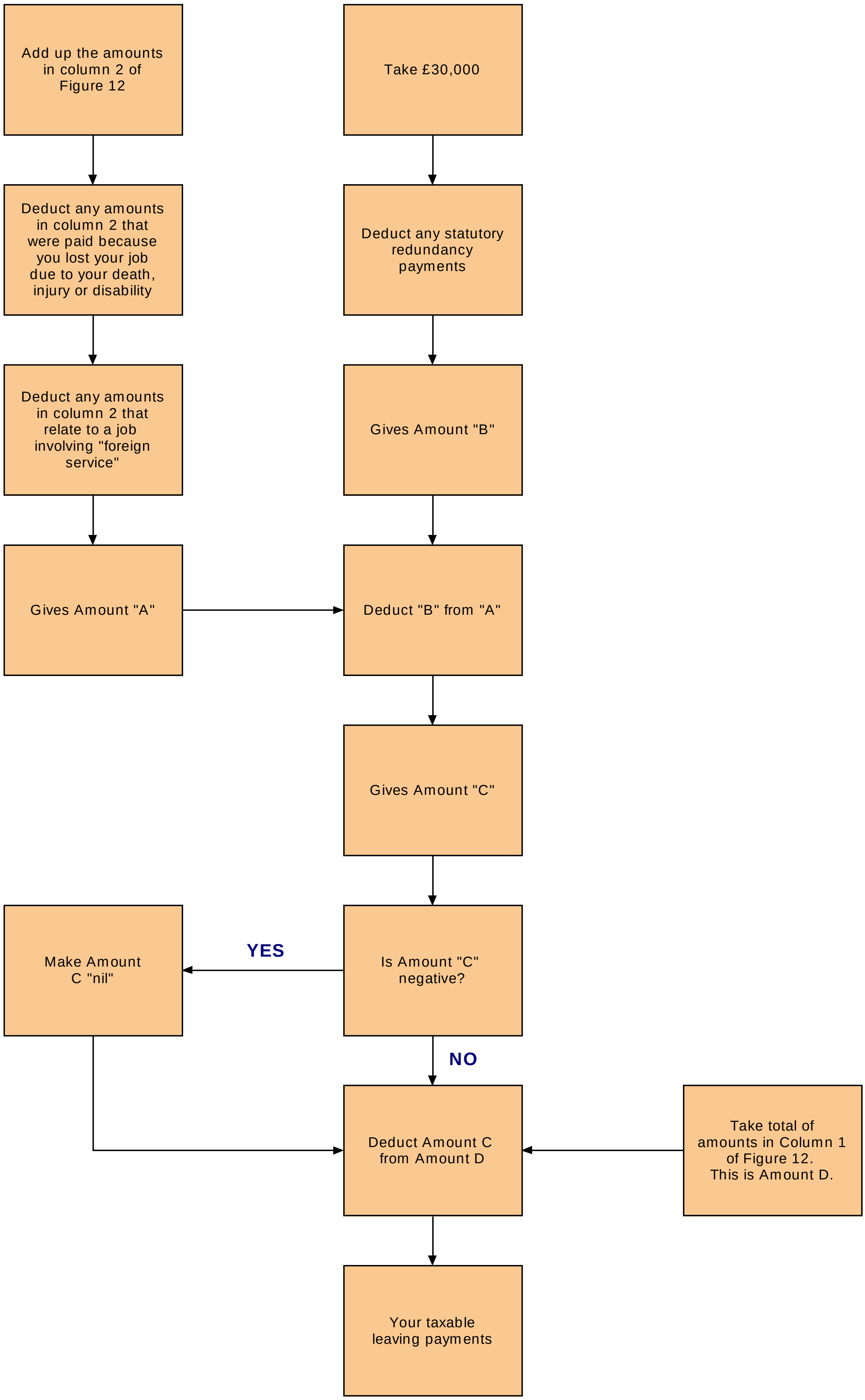
1 Always taxable	2 Taxable, but with deductions	3 Never taxable
Payments under the terms of your employment – such as holiday pay, bonuses – except those that are only paid as a result of your redundancy	**Compensation for loss of your job**	Payments **from** an **approved pension scheme** or statutory pension scheme
Pay in lieu of notice	**Ex-gratia payments**	**Contributions** by employer **to** an **approved pension plan** (as long as you remain within your annual contribution limits – see 18.2)
Compensation for **changes in the terms and conditions** of your job	**Non-statutory redundancy payments**	**Statutory redundancy payments**
Payment for agreeing **not to do something** (e.g. not poaching staff after you leave)	**Other payments** not listed as "never taxable" or "always taxable"	
Contributions by employer **to** an unapproved pension scheme (but there is an exception for contributions made because of an accident at work - see "never taxable")		**Contributions** by employer **to** an unapproved pension scheme, made because of an accident at work
Payments from an unapproved pension scheme (but there is an exception where you paid the contributions, or your employer paid them and you paid the tax on them – see "never taxable")		**Payments from an unapproved pension scheme** where you paid the contributions, or your employer paid them and you paid the tax on them

To calculate what tax you will pay on your "leaving payments", you need to follow these steps illustrated by the flowchart below.

Your taxable leaving payments are not treated as earnings when calculating your tax bill for the year. Instead, they are taxed **after** your investment income (i.e. it is treated as the "top slice" of your income). So, in the example given in 2.9 in Section 2 above, if Kate had received taxable leaving payments, these would be taxed **after** her interest and dividends, at a rate of 40%

As you can see from Figure 12 and from the flowchart below, some payments that you receive will be taxable, and some will not. Therefore, when negotiating what your employer is going to pay you, it is critical that you look at how much you are going to receive ***after tax***. If a large sum is involved, we recommend that you take professional advice from a tax adviser.

TIP	Minimise the tax that you pay on any “leaving payments”		
GET	£1,000’s	**EASE OF USE**	Difficult
What you need to do	Look at Figure 12 above and try to negotiate a deal which involves (in order of priority) payments from column 3 and then column 2 Consider taking professional advice		


Add up the amounts in column 2 of Figure 12
Deduct any amounts in column 2 that were paid because you lost your job due to your death, injury or disability
Deduct any amounts in column 2 that relate to a job involving "foreign service"
Gives Amount "A"
Take £30,000
Deduct any statutory redundancy payments
Gives Amount "B"
Deduct "B" from "A"
Gives Amount "C"
Is Amount "C" negative?
YES
Make Amount C "nil"
NO
Deduct Amount C from Amount D
Take total of amounts in Column 1 of Figure 12. This is Amount D.
Your taxable leaving payments

**** HELPFUL HINTS ****

The 6 **most common reasons** why an employee receives less salary than he/she should:

	Reason	Refer to
1	Incorrect tax allowances are included in your tax code	2.4
2	You make financial contributions towards a fringe benefit, but the full taxable value of the benefit is included in your tax code	7.15
3	Your fringe benefits have changed in the tax year, but your tax code has not been changed to reflect the reduction in their taxable value	7.15
4	Your tax code includes inaccurate estimates of items on which you get tax relief, such as your pension contributions and gross interest	7.2.1
5	You overpay National Insurance contributions where you have more than one job	7.6.2
6	You pay tax on fringe benefits even though you are a "lower paid" employee	7.12.2

The **single biggest reason** why people pay **too much tax**

1	Poor planning and organisation	3.1 and 3.2

8 PEOPLE WHO ARE SELF-EMPLOYED

You should read this Section if you have been self-employed during the tax year, or you are thinking about becoming self-employed in the future.

In this Section, you will learn;

- **How to claim a tax deduction for costs you paid before you were self-employed**
- **Whether you should trade as a sole trader or as a limited company**
- **What expenses you can claim against tax**
- **About capital allowances and how they reduce your tax bill**
- **How you can get money out of your business without paying any tax**
- **How you can save tax by paying your spouse**
- **How to reduce your accounting profits (and why this reduces the tax you pay)**
- **The importance of choosing the right accounting date**
- **How to get an immediate tax refund if you have tax losses**

8.1 Introduction

If you operate a business as a sole trader, as a partner in a partnership, as an independent contractor or as a consultant, you are self-employed for tax purposes.

You are not self-employed if you are running your business through a limited company.

If you are employed and you also have some other “freelance” activity, you will be taxed on your “freelance” business as a self-employed person.

As a self-employed person, you are required to pay income tax on the **profits** of your business. In order to calculate what these profits are, you will have to get accounts prepared for your business every year.

If you are self-employed and aged between 16 and 60 (for women) or 65 (for men), you **must** pay Class 2 National Insurance Contributions. The current rate for 2006/07 is **£2.10 per week**. You will **also have to pay Class 4 contributions** on the **profits or gains from your business**. Class 4 contributions are collected by the Revenue at the same time as the income tax on those profits.

Also, if you take your spouse into your business, remember that they will have to pay National Insurance Contributions as well;

- If your spouse joins your business ***as a partner***, they will have to pay Class 2 and Class 4 National Insurance Contributions as a self-employed person as described above;
- If you just pay your spouse a salary (i.e. he or she is ***an employee***), then he/she will pay Class 1A National Insurance contributions by deduction from his/her salary in the normal way.

8.2 Registration

The Inland Revenue can fine you **£100** if you do not inform them within 3 months of your becoming self-employed.

You should call your local Tax Office, or the National Insurance Contributions Office, to arrange for your "registration" as a self-employed worker.

TIP	Register with the National Insurance Contributions Office		
SAVE	£100's	**EASE OF USE**	Simple
What you need to do	Contact your Tax Office or the National Insurance Contributions Office on 0191 213 5000		

8.3 Don't pay National Insurance contributions

If your earnings from your self-employment are low (below £4,465 for 2006/07), you can apply for a certificate of exemption, which will allow you not to pay any Class 2 National Insurance Contributions (NICs). (Refer back to 2.12 if you cannot remember what makes up your "earnings" for the NICs purposes).

Whilst this will save you money in the short-term, **it may pay you to make contributions anyway in order to safeguard your State pension**.

You can check out the pros and cons of not paying Class 2 contributions with the Department for Work and Pensions (DWP).

TIP	Apply for a certificate of exemption from National Insurance Contributions.		
SAVE	£100's	**EASE OF USE**	Simple
CONSIDER	This will have implications for the pension that you are entitled to receive when you retire. Take advice before going ahead.		
What you need to do	Speak to the Department for Work and Pensions on 0845 7143143		

8.4 Three Tips for new businesses

The rules for the taxing of a new business are a little complex, and we won't explain them in detail here, but they will result in an amount of the profit that is earned in your first accounting period **being taxed twice**, **unless** the accounts of the business are prepared up to a date between 31st March and 5th April. (Note: The final date of an accounting period is called the "accounting reference date" or "accounting year-end").

The amount of profit that is taxed twice is called "overlap profit".

8.4.1 Keep a record of overlap profits

You need to keep a record of the amount of your overlap profits, because you will be allowed to claim a deduction for these profits when your business comes to an end, even if this is many years into the future.

TIP	Keep a record of any overlap profits		
SAVE	£1,000's	**EASE OF USE**	Simple

8.4.2 Minimise the taxable profit of your first accounting period

As some of your first accounting period's profit is taxed twice, it will pay you to keep the profits of your first accounting period as low as possible.

There are a number of techniques that can be used to reduce your accounting profits (and therefore also your taxable profits), including;

- Providing for specific bad debts,
- Reducing stock values (see 8.15),
- Reducing the value of any "work in progress",
- Delaying invoicing of customers until the start of the next accounting period,
- Accruing for costs that have not yet been invoiced to you.

Also, you can reduce your ***taxable*** profits by signing contracts for capital expenditure just before the end of the year, as you will be able to claim capital allowances on the value of this expenditure (see 8.13.6).

These techniques do not reduce your profits ***absolutely***, they merely ***delay*** profits from one accounting and tax year to the next. However, because some of the profits of your first accounting period are taxed twice, this will reduce the tax that you pay in your first two tax years.

You should talk to your accountant about how this can be done.

TIP	Keep the profit that you make in your first accounting period as low as possible		
SAVE	£1,000's	**EASE OF USE**	OK
CONSIDER	You may have reasons why you need to report a higher accounting profit for the first period, e.g. you want to get a bank overdraft. You will have to decide which factor is most important.		
What you need to do	Before your accounting year-end, you should decide whether you want to minimise or maximise your accounting and taxable profits. If necessary, talk to your accountant about how you can minimise your profit using the techniques mentioned above.		

8.4.3 Choose your accounting date carefully

If you have an accounting year-end **at the end of the tax year** (between 31st March and 5th April), this;

- avoids the "double tax" charge at the start of your trade, as referred to in 8.4.1 above, and
- makes the completion of your Tax Returns much easier.

However, **the earlier** in the tax year that you end your accounting period**, the longer that you have** to work out your tax bill and submit your Return.

ILLUSTRATION

If you have a business that is more than 3 years old, the taxable business profits that you report in your 2005/06 Tax Return, and the tax that you pay, will be based on your business's accounting profit for the ***accounting period that <u>ends</u> between 6th April 2005 and 5th April 2006****.*

So, for example, Tom, Dick and Harry, who are sole traders with accounting years ending 30th April 2005, 30th June 2006 and 31st March 2007, will pay tax ***at the same time*** *on the taxable business profits that they earn in these accounting periods (as they will each be reported in the 2005/06 tax year).*

TIP	You can give yourself longer to work out and pay your tax bill by choosing an accounting year-end that is early in the tax year.		
BENEFIT	£1,000's	**EASE OF USE**	Simple
CONSIDER	If you choose an accounting year-end that is not between 31st March and 5th April you will pay a "double tax" charge on some of your first period's accounting profits.		
What you need to do	Discuss this with your accountant		

8.5 Pre-trading expenditure

If you spent money relating to your business in the seven years **before you started trading**, you may be able to deduct these items when calculating your first year's taxable profits. The expenditure is treated as an expense incurred on the first day of trading.

This expenditure could include;

- The cost of a computer bought before you started up in business that you now use for business purposes;
- Market research costs; and
- Product development and testing

Pre-trading expenditure is only allowable if it can be shown to relate directly to your business **and** if it would have been deductible for tax purposes had it been incurred after the business had started.

TIP	Claim a deduction for costs incurred prior to the start of trading		
SAVE	£1,000's	**EASE OF USE**	OK
What you need to do	Include the costs in the relevant box of the Self Employment pages of the Tax Return (Boxes 3.51 to 3.63) dependent upon the nature of the cost concerned. Also include an explanation of the costs that you have included in the "Additional Information" box 3.116.		

8.6 Keep accurate and complete records

It is vital to keep a full record of anything that may apply to your business.

You should **always keep**;

- Your bank statements,
- The original copy of any document that explains costs that you have incurred in your business (e.g. invoices, orders, receipts),
- Copies of any invoices that you have sent to customers,
- Correspondence with the Inland Revenue and Customs & Excise.

This will make preparation of your Tax Return easier, for you or your accountant. It will also mean any requests from the Revenue can be dealt with quickly and accurately.

This won't save you tax, but it will reduce the fees that you pay to your accountant and/or your tax advisor.

TIP	Keep complete and accurate records for your business		
SAVE	£1,000's	**EASE OF USE**	OK

8.7 Sell assets to your business

When you start your business, make sure that any assets that you own that will be used in your business are bought from you at a reasonable "market value" by your business.

There are two reasons for doing this;

- You will not pay tax on the money that your business pays you for these assets; and
- Your business can claim capital allowances (a tax deduction) on the amount that it pays for these assets. If this is relevant to you, you should have a quick read through our Guide to Capital Allowances which is included as Appendix 4 to this Guide.

Your business does not have to pay you for these assets on Day 1. Instead, your business can owe you this money and repay the amount gradually over time. You will not pay tax on these repayments.

TIP	Sell assets to your business		
SAVE	£1,000's	**EASE OF USE**	Simple
What you need to do	Legally transfer the assets. You will need to make sure that the title to the asset is transferred into the name of your business (including any active warranties that protect the asset concerned). You should also submit an invoice to your business describing the assets that have been sold and their price.		

8.8 Sole trader or limited company?

This is a fundamental question for people who are considering starting their own business. Before trying to answer it, let's define what we mean by "sole trader" and "limited company".

A "**sole trader**" is the simplest form of business and is traditionally a person who trades on his/her own. You do not need to file any forms with any authorities to commence trading as a sole trader. You are manager and owner all in one. A sole trader is personally responsible for all amounts owed to creditors and the government. This means that, should the sole trader not be able to make suitable arrangements to settle any debts, his/her personal possessions (including the house) will be fair game to the creditors.

A **limited company** has at least two directors, a company secretary (which can be one of the directors) and at least one shareholder. There is a significant administrative burden that comes with "limited company" status, including the regular filing of standard documents at Companies House, but there are three distinct advantages;

- **Limited liability** – the directors of a limited company are **not personally liable** for the company's debts, unless it can be proven that they acted fraudulently,
- **Status** – a business has the perception of being more established, more professional and more reputable if it is a limited company,
- **Credit** – it is much easier to borrow money from banks and other institutions if you are a limited company.

Having established what we mean by sole trader and limited company, let us now turn to the main question – which is best?

8.8.1 At the start of trade

In tax terms, the general rule is that, **if you expect to make a loss during the first accounting period, you would be better to start out as either a sole trader or partnership**.

Why? Because, as a sole trader (or a partnership), any losses in the first 4 years of trading can be "carried back" and set against your employment income in the 3 tax years before you started your own business.

This procedure of "loss carry back" means that the tax for the period which the loss is being "carried back" to is re-calculated **as if the loss had occurred in that period**. **This is a significant tax planning opportunity.** To see how this works, let us look at an example.

EXAMPLE

Jennifer Redpath sets up a printing business and she knows there will be a loss in the first year because of the large set up costs that she is going to incur in getting the business up and running.

Jennifer starts trading on 1st April 2005. She produces accounts for the first time to 31st March 2006 and her taxable loss based on these accounts is £12,000.

Before Jennifer set up her business she was a Sales Manager for a printing company and she earned a salary of £55,000 a year. The loss of £12,000 can be "carried back" into the previous tax year, providing her with a tax refund of £4,800 (40% tax).

We realise that it is not always easy to know before you start up in business whether you will make a loss or not but, **if there is any chance that you might**, then it will probably be better for you to start as a sole trader or partnership. You can form a limited company as soon as you become profitable.

TIP	If you think that you might make a loss in your first accounting period, you can save tax by starting off in business as a sole trader or partnership.		
SAVE	£1,000's	**EASE OF USE**	OK
CONSIDER	The non-financial aspects of being a sole trader – the benefits of reduced "red tape" against the disadvantages of full liability for the business's debts, reduced ability to obtain finance and the perception of being a smaller, less reputable, business.		

8.8.2 Established businesses

Once your business is established, there is little difference in tax terms between trading as a limited company or as a sole trader/partnership.

To help you understand the picture, Figure 13 below compares the tax bill for a sole trader and a limited company earning the same level of taxable profit. This takes account of recent changes announced in the 2006 Budget which means that all companies pay Corporation Tax at a rate of 19% on profits up to £300,000.

You should note that the tax that you will pay if you run your business through a Company will depend upon how you take your money out of the business. Figure 13 assumes that,

- you pay yourself the minimum level of salary to comply with Minimum Wage legislation, and
- you take whatever other money you need out of the company in dividends[7].

This is the most tax-efficient way that a business owner can take money out of a company.

[7] Dividends can be paid out of a company only when that company has "distributable reserves". A company will have distributable reserves when it has made more profit (after-tax) than it has paid out by way of dividends. This calculation is done for the period since the company started trading. You should take professional advice before paying yourself a dividend.

Figure 13: Tax on sole traders and companies

	Taxable Profit			
	£10,000	**£15,000**	**£20,000**	**£30,000**
Sole Trader[8]				
Income Tax	834.08	1,934.08	3,034.08	5,234.08
Class 2 NI	109.20	109.20	109.20	109.20
Class 4 NI	397.20	797.20	1,197.20	1,997.20
Total Tax	1,340.48	2,840.48	4,340.48	7,340.48
Net Income	**8,659.52**	**12,159.52**	**15,659.52**	**22,659.52**
Company				
Income Tax	725.07	1,715.07	2,705.07	4,685.07
Class 1 NI	0	0.00	0.00	0.00
Employers NI	0	0.00	0.00	0.00
Corporation Tax	943.35	1,893.35	2,843.35	4,743.35
Tax Credit on dividend	-446.85	-896.85	-1,346.85	-2,246.85
Total Tax	1221.57	2,711.57	4,201.57	7,181.57
Net Income	**8778.43**	**12,288.43**	**15,798.43**	**22,818.43**
Benefit of trading as a Company (£)[9]	**118.91**	**128.91**	**138.91**	**158.91**
Benefit of trading as a Company (%)	**1.19%**	**0.86%**	**0.69%**	**0.53%**

Figure 13 shows that you will pay marginally less tax if you operate as a company rather than as a sole trader, but the difference is not significant.

Given this, your decision as to whether to trade as a sole trader or a company, should be driven by other factors, such as the non-financial considerations that we have outlined in 8.8 above.

TIP	Save tax by trading as a company rather than as a sole trader or a partnership		
SAVE	£1,000's	**EASE OF USE**	OK

[8] A sole trader is taxed whether he/she takes the money out of the business or not
[9] These figures assume that the taxpayer has no other source of income, makes no pension contributions and has no children

What you need to do	Estimate the taxable profit or loss that you expect to make in your first period of trading (excluding any salary or drawings for yourself). If this is a loss, and this loss would enable you to claim a tax refund from a previous year, I would suggest that you should start as a sole trader **unless** there is a critical reason why you need to be a limited company (for example, the business will not succeed without external finance, and you can only get this finance if your business is a limited company). You can easily change to a limited company when you start to make a profit. If this is a profit, your decision should be driven by non-financial considerations.

8.8.3. Family-owned companies

Up until 2003, the owners of family companies could save tax by making dividend payments to the lower-earning spouse (to maximise use of their personal tax allowance, and minimise the family's exposure to the higher tax rate).

However, in 2003 the Revenue said that dividend payments should reflect the involvement of each family member in the business, and not the proportion of shares that they owned, and where dividend payments did not reflect this involvement the Revenue said that they should regard the dividends as if they had been paid in proportion to the relative time spent. Thus, if a man worked 100% of his time in the business and his spouse only worked 50% of her time, the spouse would be treated for tax purposes as receiving only 33 1/3% of the total dividends paid (being half of the dividends received by her husband).

Understandably, this caused a bit of a stink!

One company that was affected, Arctic Systems, appealed against the Revenue's interpretation to the Revenue's own Special Commissioners, and then subsequently to the High Court and the Court of Appeal. To cut a long story short, the case is soon to be considered by the House of Lords, and the issue won't be clear until then.

What to do: If you are a family-owned business, and you are likely to be affected by this ruling, the Revenue should already have contacted you and advised you what to do. If you have not heard from the Revenue, sit tight for the time being and keep watching the financial press for any developments in HM Revenue & Customs vs Arctic Systems.

TIP	If Arctic Systems win their case, you will be able to reduce your family's overall tax bill by paying dividends to the lower rate taxpayer.		
SAVE	£1,000's	**EASE OF USE**	Simple
What you need to do	Nothing yet! Under Company Law, dividends can only be paid in proportion to the number of shares owned, so if you want to pay more dividends to your spouse to use up his/her personal allowance, or to take you out of the higher rate tax bracket, you will need to make sure that he/she owns sufficient shares. Helpfully, transfers of shares between spouses do not attract Capital Gains Tax (see19.2 below).		

8.9 Deductible business expenses

The rules that govern what expenses are "tax deductible" are more generous for self-employed people and companies than they are for employees.

As a self-employed person, you are allowed to claim a tax deduction for any costs that you have incurred "**wholly and exclusively**" for business purposes.

This will include;

- Any business-related expenditure incurred in the 7 years before trading began ("pre-trading expenditure" – see 8.5)

- Goods and materials

- Employees wages and related tax and national insurance costs

- Premises costs

- Selling costs

- General running expenses

- Costs of leasing equipment

- Subscription to a professional body related to your trade

- Interest and costs of obtaining loan finance (see 8.11 below)

- Protective clothing and other costs of complying with health and safety regulations

- Work travel – but **not** costs of travelling from "home to work"

- Car mileage (see 8.12 below)

- Accommodation and food on business trips

- Bad debts written off

- Accountancy costs and tax advice costs

- Staff entertaining

You **cannot** claim a deduction for;

- Any expenditure not incurred "wholly and exclusively" for the purposes of your trade

- Capital expenditure, which basically means the purchase of an asset of a permanent nature, such as plant, machinery, equipment, cars, furniture and buildings (although you can claim "capital allowances" on this expenditure – see 8.13)

- Interest on overdue tax and penalties

- Costs of home to work travel

- Depreciation

- Drawings

- Entertaining

- Gifts to customers (over £10)

Appendix 5 lists typical business expenses, clarifying what can and cannot be claimed (deducted) for tax purposes.

Don't try to minimise your tax bill by ignoring the rules on what expenses are disallowable – as you will be found out when the Revenue investigate your Return and you will be liable for penalties and interest.

Instead, you should look to **minimise your tax bill** by **maximising your tax deductions**. In order to do this, you should;

- Use the above list, and Appendix 5, as a checklist to make sure that you are **claiming a deduction for all business costs**; and

- Pay particular attention to those items that are **not included** in **the accounts of your business** as a matter of course, but which you are **still allowed to deduct for tax purposes**. These include;

    - Pre-trading expenditure (see 8.5)
    - Household expenses (see 8.10)
    - Interest and costs on loans that you have taken out (see 8.11)
    - Business mileage in your own car (see 8.12)
    - Capital allowances (see 8.13 and Appendix 4)
    - Costs that you may have paid for yourself (such as professional subscriptions and clothing)

TIP	Claim the maximum deduction for all allowable business expenses		
SAVE	£1,000's	**EASE OF USE**	Simple
What you need to do	Get accounts prepared for your business Identify tax deductible costs that are not included in your accounts Include these costs in Boxes 3.46 to 3.63 and 3.70 and 3.71, as appropriate, along with the costs from your accounts		

8.10 Household expenses

8.10.1 Claim a deduction for household expenses

If you are self-employed and you work from home, you could be missing out on significant tax savings by not claiming a deduction for all allowable household expenses.

As a self-employed person, you can claim for;

- Specific costs that you incur as a direct result of your working from home, such as cleaning or security costs, or the costs of repairs and decoration to the rooms that you use for business purposes, and

- A proportion of certain household costs, such proportion calculated using the following formula;

  $$\frac{\text{number of rooms used for business purposes x percentage use of those rooms for business purposes}}{\text{number of rooms in the house}}$$

  In calculating this proportion, you should exclude bathrooms, kitchens and toilets from the number of rooms in your house, but you should include the Garage if it stores tools or the vehicle that you use for your business.

  You should apply this proportion to the total of the following household costs;

    - council tax,
    - gas,
    - electricity,

- home and contents insurance, cleaning,
- sewerage and water rates,
- window cleaning,
- costs of maintaining the structure of the house, and
- mortgage interest.

Some people advise against including council tax, rates and mortgage interest in this calculation, but we do not see why. Our advice is to include them.

As far as telephone costs are concerned, you can claim a tax deduction for the costs that you incur in making **business** telephone calls **from home**;

- If you have a telephone line that is solely for business purposes, you can claim all the costs as a tax deduction (including rental and installation costs).

- If you have one telephone line that you use for business and private purposes, you cannot claim any element of the rental or installation costs as a deduction. In this instance, you will need to keep a log of the time that you spend on business calls, so that you can apportion the cost of calls on your telephone bills between private and business use.

TIP	If you work from home, claim a tax deduction for a proportion of your household expenses.		
SAVE:	£100's	**EASE OF USE**	OK
CONSIDER	If you do not take appropriate steps, part of the capital gain that you make on the sale of your house may be taxable if you claim a deduction for household expenses (see 8.10.2 below).		
What you need to do	Keep records of your household expenses Calculate the proportion of these expenses that you can treat as "tax deductible" Include this proportion of your household costs in Box 3.52 of the Tax Return		

8.10.2 Rooms used exclusively for business purposes

Warning: If rooms are used **<u>exclusively</u>** for business purposes, you will have to pay Capital Gains Tax on part of the taxable gain that you make when you sell your home. Capital Gains Tax is discussed in more detail in Section 19, but it is worth discussing this particular issue here.

The part of the taxable gain that you will have to pay Capital Gains Tax on is calculated as follows;

Step 1: Calculate the "occupation fraction", being:

$$= \frac{\text{the number of rooms used exclusively for the business}}{\text{the total number of rooms in the house}}$$

Step 2: Calculate the "ownership fraction", being:

$$= \frac{\text{the period that you have run your business from home}}{\text{the period that you have owned your home}}$$

Step 3: Calculate the "business fraction" by multiplying the occupation fraction by the ownership fraction. This gives the part of the taxable gain that you will have to pay Capital Gains Tax on.

In a rising property market, this may end up being a sizeable sum - the tax on which could be much higher than the tax that you have saved by claiming a deduction for household expenses.

EXAMPLE

Carl Luker bought a house in December 2002 and sold it in March 2006, making a capital gain of £100,000. During this time, he ran his architects business from home, using 1 room out of 10 for business purposes, and he incurred £5,500 in household expenses that could be apportioned to his business (electricity, rates, insurance etc).

Carl claimed 1/10 of all household expenses as being business-related (£550) and obtained a tax deduction for them in the tax years 2001/02 to 2004/05. As a basic rate taxpayer, this saved Carl £121 in tax.

However, because he has claimed these expenses, 1/10 of his home is excluded from the "main residence" exemption for Capital Gains Tax purposes.

As a result, he has a chargeable gain of £100,000 x 1/10 = £10,000.

Deducting Carl's annual CGT allowance for 2005/06 of £8,500 leaves Carl with a taxable gain of £1,500, on which he would pay tax of £330.

*In this example, Carl would have been over £200 better off by **not** claiming a deduction for a proportion of his household expenses.*

To avoid having to pay Capital Gains Tax on part of the gain that you make on the sale of your house, make sure that your "business" rooms **are not used exclusively for your business**.

You could consider using your business rooms;

- for personal storage, (maybe a wine rack or a cupboard holding your golf clubs), or
- as a "guest room" (equipped with a sofa bed), or maybe just
- as a TV room (equipped with a small portable TV).

All these would be adequate to avoid paying CGT on the sale of your house.

If you take these steps to avoid a CGT liability, you must remember to adjust your tax deduction for household costs to reflect the "non-business" usage of your business rooms.

ILLUSTRATION

If you calculated that £500 of your household costs could be apportioned to your study, but that you also kept a sofa bed in your study and it was used by guests for 10 nights of the year, you would need to reduce your tax deduction by 355/365 (to £486.30).

TIP	If you are claiming a deduction for household expenses in your Tax Return, make sure that your "business" rooms are not used **exclusively** for your business in order to avoid a Capital Gains tax bill when you sell your house.		
SAVE	£1,000's	**EASE OF USE**	Simple

8.11 Loan interest

Interest on any borrowings by **your business** is deductible for tax purposes as long as the money borrowed is used for business purposes. It does not matter whether the interest is incurred on a loan, on a bank account that has gone overdrawn, or on a company credit card.

If **you** borrow money to buy assets for use in your business (such as a car or a piece of equipment), then you can claim a deduction for this interest, although the deduction will be reduced if you also use the asset for private purposes.

ILLUSTRATION

If you have borrowed money to buy a computer, and you use the equipment for private use for 33% of the time, only 67% of the interest cost that you pay on the borrowing will be allowed as a deduction for tax purposes.

TIP	Claim a deduction for interest		
SAVE	£1,000's		Simple
What you need to do	Keep records to show that the money (the loan/overdraft/credit card cost) was spent on your business. Include the interest cost in Box 3.60 of your Tax Return		

8.12 Using your own car

If you use your own car for business purposes, you can claim a tax deduction at the Inland Revenue approved rates (the "AMAP" rates).

For 2005/06 and 2006/07, the AMAP rates are 40p per mile for the first 10,000 business miles, and 25p for every mile thereafter.

TIP	Claim a tax deduction for business mileage in your own car		
SAVE	£100's	**EASE OF USE**	Simple
What you need to do	Keep an accurate day-by-day record of your business mileage Calculate the tax deduction at the end of the tax year Include the deduction in Box 3.56 in your Tax Return		

8.13 Capital allowances

In the accounts that are produced for your business, your accountant will calculate something called "depreciation". Depreciation is a measure of the reduction in value of your capital assets (property, machinery, plant etc) over the accounting period, and it reduces your accounting profit.

Depreciation is not allowed as a tax deduction. In its place, you are allowed to deduct something called "capital allowances". Included as Appendix 4, is our Guide to Capital Allowances. If you have not read it yet, or cannot remember how Capital Allowances are calculated, read this Appendix now.

Capital allowances are calculated for the same period as the accounts that are produced for your business.

ILLUSTRATION

If you are calculating the taxable profits for your business for the year ending 31st December 2005, for inclusion in your 2005/06 Tax Return, you will calculate capital allowances for the year ended 31st December 2005.

There are two basic forms of capital allowance – a "first year allowance" and a "writing down allowance". Writing down allowances are explained in the Appendix and are not touched on again in this book, as there are no specific tax saving Tips associated with them. First year allowances are described below.

8.13.1 First year allowances

The "first year allowance" represents the tax deduction that you can claim in the year that an asset is purchased. It is calculated as a percentage of the asset's cost (**excluding** VAT).

The amount of the first year allowance depends on the size of your business and the type of asset that you have bought;

- All businesses can claim a first year allowance of 100% in relation to expenditure on specifically defined items – including designated energy saving plant and machinery, new electric cars and low carbon dioxide emission cars (up to 1 April 2008) and environmentally beneficial plant and machinery. See 8.13.2.below for more details.

- "Small businesses" can claim a special "first year allowance" of 50% for 2005/06 and 2006/07 on purchased capital items (i.e. plant and equipment, fittings and furniture, machinery), but **excluding** motor vehicles.

- "Medium sized business" can claim a special "first year allowance" of 40% for 2005/06 and 2006/07 on purchased capital items, but excluding motor vehicles

- "Large businesses" can only claim the standard capital allowance of 25% on purchased capital items.

- As far as motor vehicles are concerned, the first year allowances that are claimed by ***all*** businesses may be restricted - this matter is explained in more detail in Appendix 4.

A "small business" is defined as one that satisfies **two** of the following three conditions;

- Turnover is less than £5.6 million

- Assets are valued at less than £2.8 million

- Less than 50 employees.

A "medium sized business" is defined as one that satisfies **two** of the following three conditions:

- Turnover is less than £11.2 million

- Assets are valued at less than £5.6 million

- Less than 250 employees.

The first year allowance is **not reduced** to reflect the period of ownership in the year.

ILLUSTRATION

*If your accounting year-end is 31st December 2005, and you are calculating your taxable business profits for the year ended 31st December 2005 for inclusion in your 2005/06 Tax Return, you can claim a tax deduction for a **full** first year allowance for an asset bought on the last day of your accounting year, 31st December 2005.*

TIP	Claim a "first year allowance" on the cost of buying capital assets		
SAVE	£1,000's	**EASE OF USE**	Simple
CONSIDER	There may be situations when it is not in your interest to claim a deduction for the higher capital allowance (see 8.13.3).		
What you need to do	Confirm that you are a small or medium sized business. Then calculate your first year allowances at the higher rate (of 40% or 50%) based on the cost of assets bought during the year Include this amount of first year allowances in Box 3.16 of your Tax Return		

8.13.2 Higher first year allowances

Information and Communications Technology

For 2003/04, **small businesses** were entitled to claim a first year allowance of **100%** on the costs of investing in information and communication technology, including;

- All kinds of computers, from mainframes to palmtops,
- Peripheral devices, including monitors, keyboards, mice, printers, scanners, CD ROM and DVD drives,
- Equipment including cabling and any electrical systems dedicated to supplying electricity to computers,
- WAP phones, 3rd generation UMTS phones and PDAs.

This increased allowance has not been available in respect of tax years since 2003/04.

TIP	Review previous years' tax returns and claim a higher tax deduction for expenditure on information and computer technology in 2003/04		
SAVE	£1,000's	**EASE OF USE**	Simple
CONSIDER	If you made significant expenditure in 2003/04 on this type of equipment, and you were a "small business" in that year, and you did not claim 100% first year allowance in your tax return for that year, and by claiming such an allowance you would reduce your tax liability for that year, it may be worthwhile asking the Inland Revenue to "re-open" your 2003/04 tax return (and to re-calculate the tax due).		
What you need to do	Write to the Inland Revenue with evidence of your expenditure and ask them to "re-open" your tax return for that, and all subsequent years, and re-calculate the tax due for those years.		

Energy-saving equipment

From 2003/04 onwards, **a business of any size** has been able to claim a first year allowance of **100%** of the purchase cost of;

- a car with a CO2 emissions level of lower than 120g/km,
- certain energy-saving and environmentally beneficial equipment for use in the business or for hire

A complete list of the technologies that qualify for a 100% first year allowance as "energy-saving equipment" is listed on the website www.eca.gov.uk.

TIP	Claim 100% first year allowance on expenditure on qualifying energy-efficient assets		
SAVE	£1,000's	**EASE OF USE**	Simple
CONSIDER	There may be situations when it is not in your interest to claim a deduction for the higher capital allowance (see below).		
What you need to do	Confirm that the assets qualify for the 100% allowance Include the amount of first year allowances in Box 3.16 of your Tax Return		

8.13.3 Disclaim first year allowances

ADVICE: *This Tip is a little technical so, before reading on, we would advise you to read through Appendix 4, Guide to Capital Allowances, if you have not done so already, and familiarise yourself with the terms "balancing charge" and "general pool".*

On the face of it, first year allowances look very attractive – they give you are larger tax deduction than you might otherwise expect. However, **you should not claim them automatically**. **Consider your overall tax position first**.

In particular, if you have a balancing charge in the general pool that is greater than the first year allowances that could be claimed on the assets that you have bought during the year, you would be better off not claiming the first year allowance and increasing the general pool by the value of these assets.

EXAMPLE

Arthur Psaltis, a higher rate taxpayer, runs a garage. He has 2 employees and his turnover for 2004/05 was £250,000. At the beginning of 2005/06, Arthur had a balance on his general pool of assets of £500. During the year, Arthur sold a lathe for £2,500, and he also bought some tyre balancing equipment at a cost of £2,600.

If Arthur claimed first year allowances on his purchases, his Tax Return would include;

> *First year allowances (tax deduction) of £1,040 (being 40% of £2,600); and*
> *A balancing charge (tax addition) of £2,000 (being £2,500 less £500).*

*Overall, these items would **add** £960 to Arthur's taxable income.*

If, however, Arthur did not claim the first year allowances, his general pool would have a value of £600 at the end of the year (being £500 plus £2,600 less £2,500) and his Tax Return would include;

> *First year allowances (tax deduction) of £nil; and*
> *A balancing charge (tax addition) of £nil; and*
> *Writing down allowances (tax deduction) of £150 (being 25% of £600)*

*Overall, these items would **reduce** Arthur's taxable income by £150.*

By not claiming his first year allowances, Arthur has reduced his taxable income by £1,110, saving himself £444 in tax.

TIP	Don't claim first year allowances if you have a large balancing charge		
SAVE	£1,000's	**EASE OF USE**	OK
What you need to do	Calculate whether you are better off for tax purposes by not claiming the first year allowance Prepare your Tax Return on this basis. Note: Many people still write to the Revenue, setting out the assets that they do not want to claim first year allowances on (along with their cost and their date(s) of purchase), but this is **no longer required**.		

Other situations in which you might look to disclaim your capital allowances are if your business is making a loss, or if its taxable profit (before claiming any capital allowances), plus any other taxable income that you have earned in the tax year, is lower than you personal allowances for the year.

Generally speaking, it will pay you not to claim any more in the way of capital allowances **than you need to reduce your tax bill to zero.**

There is one situation when this does not hold true – and that is when **you have a use for a tax loss** (either in terms of reducing tax that you will have to pay on other taxable income in the current tax year, or in terms of getting a refund for tax paid in previous years). Business losses and what you can do with them are discussed in more detail on 8.19 below**.**

The whole area of business losses, and what you can do with them, is relatively complex and you should always be looking to take professional advice to ensure that you make the best use of your losses.

TIP	Don't automatically claim first year allowances if you will not pay tax without claiming them. Take advice first.

SAVE	£1,000's	**EASE OF USE**	Difficult
CONSIDER	You may be able to get a refund for tax paid in a previous year, if you can generate a tax loss in the current year		

8.13.4 Short life assets

ADVICE: *This Tip is a little technical so, before reading on, we would advise you to read through Appendix 4, Guide to Capital Allowances, if you have not done so already, and familiarise yourself with the terms "balancing allowance" and "general pool".*

A claim can be made for assets with an expected life of less than five years, for example computers, to be treated as "short-life assets".

Short-life assets are not added to the general "pool" of assets on which tax allowances are calculated.

Instead, they are kept separately in their own "pool" and, when they are disposed of, the business can immediately bring to account in its tax calculations any balancing allowance on those assets.

This is likely to work in your favour if you cannot claim 100% first year allowance on the assets, as the assets are likely to lose actual value more quickly than will be depreciated for tax purposes.

By keeping such assets separate from other assets, their disposal will create a balancing allowance for tax purposes (as the sales price is likely to be lower than the tax written down value), and this balancing allowance will reduce your taxable profit in the year of disposal.

EXAMPLE

Ian Puckett buys an overhead projector for £1,750 for his business in January 2003. In November 2005, Ian buys a replacement projector and he gives the original projector to his son's school.

If Ian had elected for the projector to be treated as short-life asset, Ian would get a balancing allowance (a deduction in his Tax Return) of £738.29 in 2005/06;

Cost of projector	*1,750.00*
Allowance in 2002/03 (@25%)	*(437.50)*
Tax written down value 05/04/03	***1,312.50***
Allowance in 2003/04 (@25%)	*(328.12)*
Tax written down value 05/04/04	***984.38***
Allowance in 2004/05 (@25%)	*(246.09)*
Tax written down value 05/04/05	***738.29***
Sale proceeds	*(0.00)*
Balancing allowance in 2005/06	***738.29***

If the projector had been added to the general pool of assets on which writing down allowances are calculated, Ian would probably not have received any specific balancing allowance (tax deduction) in connection with the disposal of the projector.

To have an asset treated as a short life asset, an election;

- must be made in writing to the Inland Revenue
- must specify the short life asset together with its cost and the date on which it was acquired
- is irrevocable.

Generally speaking, you have at least 2 years from the date that the expenditure was incurred in order to make this election.

TIP	Elect for assets that lose value quickly to be treated as "short life assets" for tax purposes.		
SAVE	£1,000's	**EASE OF USE**	OK
What you need to do	You must write to the Inland Revenue as described above.		

8.13.5 Buying on credit

You do not have to buy an item outright to claim capital allowances.

You can claim capital allowances for an item bought with a loan or on hire purchase, based on the cost of the item.

However, you cannot claim allowances for an item bought on a finance or operating lease.

TIP	Claim capital allowances on items that you have not bought outright.		
SAVE	£1,000's	**EASE OF USE**	Simple
What you need to do	Include the value of these allowances in Box 3.16.		

8.13.6 Maximise capital allowances

The date that you sign a contract to buy new equipment for your business will determine the earliest tax year for which capital allowances can be claimed.

It is often worth signing a purchase contract just before, rather than just after, your accounting year-end, in order to maximise your capital allowances deduction.

TIP	If your business is profitable, consider contracting to buy equipment just before your accounting year end in order to reduce taxable profits		
SAVE	£1,000's	**EASE OF USE**	Simple
What you need to do	Sign a legally binding purchase contract for an asset before the end of the year. Calculate capital allowances on the cost of this asset, even though you have not paid for it. Include these capital allowances in the total that you put into Box 3.16 of your Tax Return.		

8.14 Pay your spouse

If your spouse is not using all of their tax allowances and he/she has some free time, you should consider getting them to help you with your business and paying them a reasonable amount for the work they do, as this will save you tax.

There are two important points here;

- The salary **must** actually **be paid** to your spouse **on a regular basis**. It is not sufficient just to make a one-off annual payment, and

- The level of salary paid must be **commercially justified**, i.e. it must be based on the market rate for the type of work done and the number of hours worked.

The same considerations would also apply if you employ your children in your business.

In broad terms, it will **always be worthwhile** paying your spouse a salary that brings their earnings for a tax year up to the value of their tax allowances for that year, as;

- they will not pay tax on the salary that they receive from you,
- the profits earned by your business will be lower by the amount of the salary that you pay, and you will pay lower tax on these reduced profits.

If your spouse is already earning sufficient income to cover his/her tax allowances, you can still reduce your overall tax bill if he/she is paid at a lower tax rate to yourself. This is best illustrated by way of example.

EXAMPLE

Bob Bowtell is a sole trader. He has a decorating business that had profits of £45,500 for 2005/06. Bob is therefore a higher rate taxpayer.

His wife, Jayne, earns £9,750 a year from being a part-time bookkeeper. Jayne is therefore a basic rate taxpayer.

Both have personal tax allowances of £4,895.

Bob will pay income tax of £9,959.20 and self-employed national insurance contributions of £2,404.65. Jayne will pay tax of £817.30 and national insurance contributions of £497.60.

Their total tax deductions are therefore £13,678.75.

If Jayne worked 10 hours a week for Bob, and Bob paid her £12.50 an hour for this work, Bob's business profits would reduce by £6,705, comprising;

Jaynes' salary of £6,500; and
NI contributions on this salary of £205.

This would save Bob income tax of £2,682 (being 40% of the decrease in his business profits) and his self-employed national insurance contributions would reduce by £67 (being 1% of the decrease in the profits of his business).

His total deductions would therefore be reduced by £2,543 (being £2,682 plus £67 less £205).

Jayne would take home an extra £4,355 – being her salary of £6,500 less her employee's national insurance contribution at 11% (£715) and less tax at 22% (£1,430). Her total deductions would therefore be increased by £2,145.

Bob and Jayne's combined deductions would therefore have been reduced by £398 by paying Jayne a salary.

TIP	Pay your spouse sufficient salary to use up all of his/her tax allowances and/or to reduce the highest tax rate applied to the higher rate taxpayer.		
SAVE	£100's	**EASE OF USE**	Simple

What you need to do	Decide what work your spouse can do for you Agree a “commercial” rate for this work by looking at job advertisements in local papers and seeing what salaries other employers in your area are offering for similar work Calculate how much time your spouse would have to spend at this agreed rate in order to increase her annual taxable income either up to the level of his/her personal allowance Formalise the terms and conditions of your spouse’s employment in a Contract of Employment (the documentation that you prepare in connection with the employment of your spouse should be no different to that prepared for any other employee).

8.15 Value stock to minimise tax

If your tax bill for the year is higher than you would like, have another look at the value of your stock at the end of the year.

Stock will normally be valued at cost – being the price that you paid for it. However, you are also allowed to value it at “net realisable value” if this is a lower figure. “Net realisable value” basically means what you think you can sell it for.

If you can reduce the value of your stock, you will reduce your taxable profits by the same amount. However, this only enables you to **delay** your tax bill, **not to reduce it**. To see how this works, lets look at an example.

EXAMPLE

Dan Packer runs a clothing shop. At the end of March 2005 his closing stock is valued by his accountant at a cost of £10,000. Dan’s accountant tells him in June, when he has completed Dan’s accounts, that Dan’s business made a taxable profit of £22,000 for 2004/05.

As a result, Dan has another look at his stock value, and he identifies some end-of-line items which he thinks he will have to sell for less than cost. He reduces his stock value to £7,500. This reduces Dan’s taxable profit to £19,500 (being £22,000 less the £2,500 reduction in the value of year-end stock).

During 2005, Dan sells all of his year-end stock for £15,000. Dan therefore makes a taxable profit of £7,500 in 2005/06 on the stock that he sold (being a sales value of £15,000 less a stock value of £7,500).

Dan’s total taxable profit over the two years is therefore £27,000 (being £19,500 for 2004/05 plus £7,500 for 2005/06).

If Dan had not reduced his stock value, he would have made taxable profits of £22,000 in 2004/05 and £5,000 in 2005/06 (being a sales value of £15,000 less stock value of £10,000). Dan’s total taxable profit would therefore still be £27,000, but £2,500 of it would be taxed a year earlier.

TIP	Be aware of the impact that the valuation of your stock has on your taxable profits. If you need to reduce profits in a year, one way of doing this is to reduce the value of your stock.

8.16 Pay down personal debt

If you happen to have a bit of spare cash hanging around, you should consider reducing your personal debts (mortgage, credit cards etc) **before** any business debts.

This is because interest on personal debt **is not** deductible against your income for tax purposes, but interest on business debt **is** deductible against your business’ income for tax purposes.

Interest on business debt will therefore reduce your taxable profits and therefore also your tax bill, but interest on personal debt does not. It makes sense, therefore, to pay off personal debts first.

ILLUSTRATION

If you are paying interest of 8% on a business loan, the effective cost (after taking account of the tax deduction that you will get) is 6.2% if you are a basic rate taxpayer and 4.8% if you are a higher rate taxpayer.

If you are paying interest of 8% on a personal loan, the effective cost to you is 8%, as you get no tax deduction

As a very general rule of thumb:

Basic Rate Taxpayers: The interest rate that you are paying on your business debt would need to be 42% higher than the rate that you are paying on your personal debt to make it worthwhile paying down the business debt first (i.e. 8.52 vs. 6%);

Higher Rate Taxpayers: The interest rate that you are paying on your business debt would need to be 69% higher than the rate that you are paying on your personal debt to make it worthwhile paying down the business debt first (i.e. 10.1% vs. 6%).

EXAMPLE

Heather Maddin, a higher rate taxpayer, runs a hairdressing salon. The salon has a bank overdraft of £10,000, bearing interest at 7.5%, and Heather has an interest-only mortgage of £50,000 on her home, bearing interest at 6.0%. Heather has just sold her car for £20,000 and she has bought a smaller one for £10,000. She wants to use the remaining £10,000 to reduce her debt.

If Heather reduced her business's overdraft, she would save £750 in interest per year although, all other things being equal, she would pay £300 more tax (as the interest would no longer be a deduction in her Tax Return). Heather would be £450 better off.

If Heather reduced her mortgage, she would save £600 in interest per year.

Overall, Heather would be better off paying down her mortgage, even though the business overdraft has a higher rate of interest.

TIP	Repay personal debt before business debt		
SAVE:	£1,000's	**EASE OF USE**	Simple

What you need to do	It is reasonable to assume that you will be better off paying down personal debt rather than business debt, without doing any complicated calculations to prove it, because; • you get a tax deduction for business interest, and • personal debt tends to have higher interest rates than business debt. However, if you want to prove it, you will need to; (i) estimate the after-tax interest rate on your business borrowing. This can be done roughly by; **Step 1:** Estimating your business profits for the tax year (excluding your own drawings) **Step 2:** Working out what tax rate and national insurance contribution rate applies to the top of these profits e.g. if you expect to make £40,000 of profit, this is 40% tax rate and 1% NIC rate, if you expect to make £20,000, this is a 22% tax rate and 8% NIC rate **Step 3:** Add the tax rate and the NIC rate together and take the total from 100% **Step 4:** Multiply the interest rate on your borrowing by the percentage worked out in the Step 3 – this gives you the after-tax interest rate on your business borrowing (ii) compare this interest rate to the interest rate that you are paying on your personal borrowing (iii) if the interest rate on your personal borrowing is higher than the after-tax interest rate on your business borrowing, (which, in nearly all circumstances, it will be) pay down your personal borrowing If the interest rate on your personal borrowing is lower than the after-tax interest rate on your business borrowing, pay down your business borrowing

8.17 "Self-employed" workers

If you use "freelance", or self-employed, staff in your business, you need to take great care that the Revenue will also regard them as "self-employed".

If the Revenue decides that one of your "self-employed" workers should actually have been treated **as an employee**, then **you are liable** to pay the tax and NIC that would have been paid if they had they been treated as an employee.

The Revenue will look at a number of "indicators" to determine whether a person is employed by a business or not. They are summarised in Figure 14 below.

Figure 14: Employed or self-employed?

Employed	Self-employed
Works at the business's premises, or a place determined by the business	Bears the risk of loss for unsatisfactory work. No fees paid to correct errors
Paid a rate, rather than a fee.	Provides own tools and equipment

Receives overtime, sick pay or pension benefits.	Is being paid a fixed fee and meets own overhead costs
Works a set number of hours	No right to any pay when there is no work available
The business has the right to state when, where and how the job is done	Can choose who does the work. Can sub-contract someone else to do it
Manages the business's staff	No permanent "presence" at the business. No permanent desk or support staff
Long periods working for the same business	Works for different businesses.

The Revenue is looking very closely at this area so, if you use self-employed workers, we recommend that you make sure of their status. You should use Figure 14 as a "checklist" on each of your own self-employed staff. You may have a problem if you tick ***more than 2*** of the indicators listed in the "employed" column of Figure 14.

Many employers think that a formal contract for the supply of services from a person will be sufficient to treat that person as "self employed". **It is not.** Even where such a contract exists, the Revenue will still go through the indicators listed in Figure 14 to determine the employment status of that person.

This is not to say that a formal contract has no value. It does. It ***may*** help the Revenue to clarify which "indicators" in Figure 14 apply to that person and, if the Revenue deem a contractor to be an employee, a contract will help you to recover from that person any tax that you have to pay to the Revenue.

8.17.1 Construction Industry

In the Construction Industry, it is normal for sub-contractors to have certificates, or registration cards, which set out how the employer should treat payments to the sub-contractor **if** the employer considers that the sub-contractor is self-employed.

The last part of this sentence is very important. The fact that a person holds a certificate does **not** mean that they are self-employed when they work for you – you still have to look at the actual terms and conditions that apply to their work for you in order to decide whether you should treat them as self-employed.

If in doubt, check

If you are in any doubt about the status of people who work for you, speak to any Inland Revenue Enquiry Centre (see your local Phone Book or Yellow Pages).

A little attention now, utilising proper contracts, may save you an expensive tax and NIC bill.

<table>
<tr><td>TIP</td><td colspan="3">Make sure that "self-employed" staff are truly self-employed</td></tr>
<tr><td>SAVE</td><td>£1,000's</td><td>EASE OF USE</td><td>OK</td></tr>
<tr><td>What you need to do</td><td colspan="3">Check the status of all of your self employed workers using the indicators listed in Figure 14 above

Check with the Inland Revenue about the status of those staff that are not clearly self employed

Get your self-employed workers to sign a standard "sub-contractor" contract (which you will be able to get from any solicitor or from one of the many legal document sites on the internet), to protect yourself in the event that the Revenue deems a contractor to be an employee.</td></tr>
</table>

8.18 Life insurance premiums

If you are self-employed and you have a personal pension scheme, you can get a tax deduction for premiums paid for a life insurance policy, if the policy is linked to your pension **and** the premium costs less than 5% of your earnings (10% of premiums for stakeholder pensions)

TIP	Claim a deduction for life insurance premiums		
SAVE	£100's	**EASE OF USE**	Simple

8.19 Business losses

If your business makes a loss for tax purposes, there are 3 ways in which you can use these losses to reduce your tax bill now;

- If you have other taxable income in the tax year (unrelated to your business), you can save tax in the current year by offsetting your business losses against this other taxable income,

- If you have paid tax in the previous tax year, you can claim a tax refund by "carrying back" your current year's business losses to the previous tax year and setting them off against your taxable income for that previous tax year,

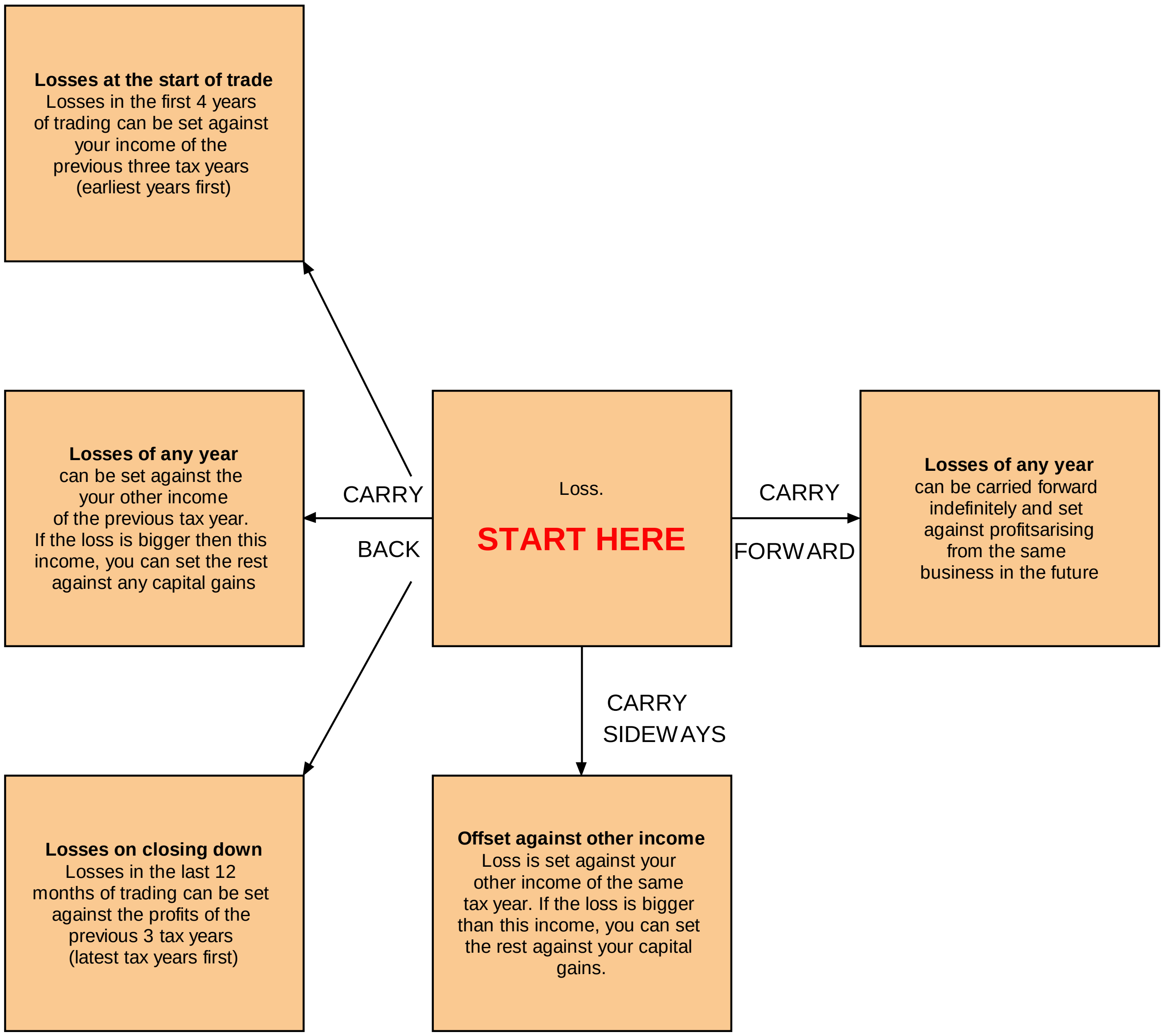
- If you have been trading for less than 4 years, you can claim a tax refund by "carrying back" your current year's business losses to the previous three tax years and setting them off against your total taxable income for those three tax years (taking the earliest years first).

This is a significant tax planning opportunity. The alternative uses of business losses are shown graphically in the diagram below.

If you cannot use your business losses in any of the ways explained above, you must carry the losses forward and they will be offset against the first profits that you make from the same business in the future.

TIP	Use your business losses to maximise your tax saving		
SAVE	£1,000's	**EASE OF USE**	Difficult
What you need to do	The rules are a little convoluted, particularly at the start and at the end of trade, so we recommend that you take advice from your accountant or tax advisor in order to determine the best way to use your tax losses.		

Uses of a Tax Loss from your Business



8.19.1 Offset against chargeable gains

As we have described in 8.19, you are permitted to offset business losses against **all** of your taxable income in the current or preceding tax year.

Your income for these purposes includes capital gains (being profits that you have made on the sale of assets during the year).

If you are considering this, you must recognise that business losses are offset against chargeable gains **before they have been reduced by Taper Relief**. (You should refer to Section 19 on Capital Gains Tax for a description of Taper Relief.). By making this offset, you therefore "waste" any Taper Relief on the asset that you have sold.

This is an important point, as Taper Relief can be a significant proportion of the total gain and you should not waste it lightly.

If you have an asset that would attract **significant** Taper Relief, you might be better claiming Taper Relief in the current year (and paying the Capital Gains Tax due on the remaining gain), and carrying the business losses forward to offset against profits in a future tax year.

EXAMPLE

Andrew Granger is a partner in a solicitors' practice and his share of their business losses in 2005/06 was £15,000. Andrew owned the office that the practice had been based in since it began 5 years ago.

In November 2005, Andrew sold the office and made a capital gain of £30,000 on its sale. As the gain relates to a business asset that has been owned for at least 2 years, this gain qualifies for 75% Taper Relief (refer to Figure 20 in 19.6).

If Andrew offsets his business losses against this chargeable gain, his taxable income would be;

Capital gain	*30,000*
Less: Business losses	*(15,000)*
	15,000
Less: Taper relief (75%)	*(11,250)*
Chargeable gain	*3,750*

As Andrew has an annual Capital Gains Tax allowance of £8,200 for 2005/06, he will not pay any tax.

Alternatively, if Andrew carried his business losses forward (and did not offset them against his capital gain), his taxable income would be calculated as follows;

Capital Gain	*30,000*
Less: Taper relief (75%)	*(22,500)*
Chargeable gain	*7,500*

Given that Andrew has an annual CGT allowance of £8,200, he will still not pay any tax ***and*** *he would carry forward his business losses to offset against future profits.*

TIP	Do not automatically offset business losses against chargeable gains. Consider how much Taper Relief you will lose by doing so.		
SAVE	£1,000's	**EASE OF USE**	OK
What you need to do	Calculate the tax that you will have to pay if you do not offset your business losses against the capital gain and, instead, take full advantage of any Taper Relief Calculate the tax that you will have to pay if you do offset your business losses against the taxable gain Decide whether it is worth losing your business's tax losses for the tax saving that you will make. In making this decision, you will need to consider what other uses you may have for the business's tax losses in the future and how much tax you will save when you use the tax losses at this time.		

8.20 PAYE and National Insurance Contributions

8.20.1 Payment of deductions

If you employ staff and you make average monthly PAYE and NIC payments to the Inland Revenue of less than £1,500, you can choose to pay this quarterly rather than monthly.

This won't save you any tax, but it will save you time and make your payroll administration a little easier.

TIP	Pay salary deductions quarterly
What you need to do	Contact the Inland Revenue's employer helpline on 0845 7 143 143 and ask to pay quarterly.

8.20.2 Benefits in kind

Benefits in kind (sometimes also called “fringe benefits” or “perks”) are benefits that;

- are provided to an employee in addition to his/her salary, and
- are paid for by his/her employer.

In most cases, fringe benefits are taxable. The amount that is taxable is called the “taxable benefit”.

The Inland Revenue have a number of rules for calculating the taxable benefit for a wide variety of fringe benefits. These rules are outlined in Figure 9 in 7.7.

If you employ staff, remember that, as their employer, **you will be liable to pay National Insurance Contributions** on any “fringe” benefits that you provide to them.

As such, there is no tax saving to you if you offer your employees a benefit instead of salary **and** that benefit has the same taxable value as the salary foregone.

In order to achieve a tax saving, the benefit that you provide must have a lower taxable value than the salary foregone.

Note: Employer’s national insurance contributions are calculated at a rate of 12.8% above a minimum threshold of £4,895 a year, or £94 a week, for 2005/06.

TIP	If you employ staff, don’t forget that you have to pay employer National Insurance contributions on any taxable benefits provided to your employees. You can save tax by offering employees taxable benefits instead of a salary increase, but only if the value of the taxable benefit is lower than the salary foregone.		
SAVE	£100’s	**EASE OF USE**	OK

8.20.3 Dispensations

A “dispensation” is authorisation from the Inland Revenue that you do not have to report certain expenses on the P11D forms that you produce for your employees at the end of the tax year.

A dispensation can cover any expenses that have been incurred by the employee wholly and necessarily for business purposes which you subsequently reimburse, e.g. travel and subsistence, credit card payments, mileage allowances, entertainment, business telephone calls and professional subscriptions.

Company cars, business fuel and Private Medical Insurance are taxable benefits that **cannot** be covered by a dispensation

Before they will agree to a dispensation, the **Revenue** must be sure that:

- no tax would be due by your employees in respect of the **expenses**,
- expense claims are independently checked and authorised within the company and, where possible, receipts are attached to the claim

Whilst the agreeing of dispensation does not provide you with a tax saving, as such, it will allow you to produce the year end Form P11D forms much more quickly and save a significant amount of administrative time and costs.

TIP	Agree dispensations for business expenses that you reimburse to your employees.

What you need to do	Contact your local Tax Office and ask them to send you IR 69 – "Expenses payments and benefits in kind – how to save yourself work", which explains the process and includes an application form

8.21 "Summary" Tax Return

If your annual turnover is less than £15,000 you do not need to itemise every expense of your business on your Tax Return. Instead you can fill in the three boxes on the front of the self-employment pages and then go directly to page three.

This will save you time, rather than money, but it is still a Tip worth knowing.

TIP	Do not fill in every box on the self-employment pages of the Return if your turnover is less than £15,000 in the tax year
What you need to do	Fill in boxes 3.24 to 3.26 on your Tax Return, but leave boxes 3.27 to 3.73 blank.

8.22 IR35

If you are self-employed, you need to be very aware of IR35.

IR35 is the term given to the controversial government legislation, which was introduced by the Government on 6th April 2000.

The legislation was aimed at closing the tax avoidance loophole that allowed individuals to;

- set up in business as a company (often termed a "Personal Service Company" or "PSC"),
- provide services to one customer,
- earn fees from that customer without paying any PAYE or NICs on those fees,
- pay themselves dividends out of their own company and pay no NICs on these dividends, and
- get a tax deduction for expenses incurred "wholly and exclusively" in the course of trade.

At the time, the Inland Revenue made much of the individual who left full-time employment on a Friday and returned as a self-employed contractor on a Monday to do, to all intents and purposes, the same job.

Since April 2000, anyone who provides services through an intermediary, such as a company or partnership, is assessed by the Revenue to determine whether they are either (a) a genuine contractor, or (b) 'akin to employed'.

If you are a genuine contractor, i.e. passed IR35, you can pay yourself a small salary and take the rest of your income in the form of dividends, which don't incur national insurance contributions (see 8.8 above).

If you fail IR35 and you are deemed 'akin to employed', you are not allowed to take dividends from your company. In this instance, all of your company's income (near enough) is treated as your salary, on which you have to pay PAYE and NICs. In comparison to the first method, this will result in a reduction of in your net income.

In deciding whether you pass or fail the IR35 test, the Revenue will look at the factors described in 7.27 above.

You will get absolutely no tax benefit from setting yourself up as a company if you fail the IR35 test, so we suggest that you make sure that you will pass the test *before* you waste your time and money on buying a company. Look through 8.17 above and speak to the Revenue before you take the plunge.

If you are a contractor and you fail the IR35 test, you should consider joining an "Umbrella Company". This will not save you any tax, but it will significantly reduce your administrative burden.

To find an Umbrella Company, speak with your accountant or tax advisor, or alternatively type "IR35 Umbrella Company" into any search engine.

TIP	Don't set up as a company if you are going to fail the IR35 test
What you need to do	Look through the standard indicators of employment/self-employment, as listed in 8.17 above. Speak to the Inland Revenue about your circumstances.

****** HELPFUL HINTS ******

New business checklist – 6 ways to reduce the tax you will pay

		Refer to
1	Choose the right vehicle for your business - sole trader or company?	8.8
2	Choose the right accounting date	8.4.3
3	Minimise the profit that you make in your first accounting period	8.4.2
4	Sell assets to your business	8.7
5	Claim a deduction for pre-trading expenditure	8.5
6	Use business losses to get a tax refund	8.19

3 Key Differences between being Employed or Self-Employed

1	If you are self-employed, you will be able to claim a tax deduction for a much greater range of costs and expenses, including some of your household costs if you work for part of the time from home.	7.17, 8.9 et seq
2	If you are employed, you may not have to complete a tax return. If you are employed, you will always have to complete a tax return.	2.3
3	If you are self-employed, you will pay Class 2 and Class 4 NI contributions, whereas as an employee you will pay Class 1 NI contributions (and possibly also Class 1A and IB contributions), and your employer will also have to pay NI contributions.	2.12

9 PEOPLE WHO OWN PROPERTY

You should read this Section if you own property.

In this Section you will learn;

- **How to cut your Stamp Duty bill when you buy a house**
- **Why you will be better off and pay less tax if you use your savings to reduce your mortgage**
- **How you can get up to £4,250 of rent each and every year tax-free**
- **How to cut your tax bill if you rent out property that you own**
- **About recent proposals to allow you to buy property through your pension plan, and why this will save you tax**

9.1 Stamp duty land tax

"Stamp Duty Land Tax" (SDLT) is the new name for Stamp Duty.

Like Stamp Duty, SDLT is charged when you buy a house. Figure 15 sets out the current rates;

Figure 15: Stamp Duty Land Tax rates. 2006/07.

Value	Rate
Up to £125,000[10]	Nil[11]
£125,001 to £250,000	1%
£250,001 to £500,000	3%
Over £500,000	4%

SDLT is charged on the **purchase** price of the **land and buildings**, including fixtures (such as fitted kitchens and bathroom suites). SDLT is charged on the **entire purchase price** at these rates.

ILLUSTRATION

A purchaser who buys a house for £247,000 will pay SDLT of £2,470 (being 1% of £247,000), whereas a purchaser who buys a house for £252,000 will pay SDLT of £7,560 (being 3% of £252,000).

Buyers sometimes agree with the seller to pay a separate sum, on top of the property price, for certain items (known as 'chattels') that the seller decides not to take with them when they move. These items include;

- curtains;
- carpets; and

[10] Increased from £60,000 to £120,000 on 17 March 2005, and to £125,000 on 23 March 2006.
[11] A limit of £150,000 applies to property in disadvantaged areas – see 9.1.1.

• other moveable items.

From 1st December 2003, all house buyers are required to submit a "Land Transaction Return" to the Revenue setting out the details of the price that they paid.

This form is aimed at discouraging homebuyers who artificially keep the declared purchase price of their house below the stamp duty cut-off points (£120,000, £250,000 and £500,000) by paying "over the odds" for the chattels.

It is critical that any apportionment of the overall **purchase** price to chattels must be on a just and reasonable basis. However, there is still scope for some tax planning if a property's value is close to the cut-off points.

As a guide, it is unlikely that the Revenue would query a value of chattels that is 5% or less than the value of the property. In some cases, a valuation of 10% might be justified.

It is possible to save thousands of pounds by negotiating your house purchase in the right way, whilst staying within Revenue guidelines.

EXAMPLE

Michael Lampard is buying a house that is on the market for £267,500.

He agrees with the owners that he will buy the house, along with the carpets, curtains, garden shed and some garden ornaments for a total price of £262,500, as long as £15,000 of this price can be allocated to the value of the chattels.

This is a reasonable amount to pay for chattels on a house of this value (£15,000 is 6% of £247,500) and should not be questioned by the Revenue.

*If Michael had paid £262,500 for the house, he would have paid £7,875 in Stamp Duty Land Tax. By paying only £247,500 for the house, Michael only pays £2,475 in SDLT**, a saving of £5,400.***

TIP	Allocate between 5% and 10% of the purchase price to chattels. Where possible, use this technique to bring the purchase price of the land and buildings down below a Stamp Duty threshold.		
SAVE	£1,000's	**EASE OF USE**	Simple
What you need to do	Agree with the seller what chattels you are buying with the house Take advice from your solicitor about a reasonable value for the chattels		

9.1.1 Disadvantaged areas

You will not pay SDLT **if** you buy a property up to a value of £150,000 in certain "disadvantaged areas". If VAT is included in the amount that is paid, it is the amount including VAT that has to be £150,000 or below in order for this relief to apply.

This relief also applies to lease premiums (an amount paid up-front in order to take on the lease of a property).

A helpline (0845 603 0135) is available for people wanting to determine whether a property is in a designated area qualifying for stamp duty relief. You will be required to provide the postcode of the property.

TIP	Check with the Revenue whether the property falls within a "disadvantaged" area.		
SAVE	£1,000's	**EASE OF USE**	Simple
What you need to do	Call the helpline on 0845 603 0135.		

9.2 Pay down your mortgage

If you have savings as well as a mortgage, you should consider using any "excess" saving (i.e. the amount that you do not need to keep as a "safety net" just in case of unforeseen events or expenditures) to pay down (or reduce) your mortgage.

This makes sense for three reasons;

- Firstly, the interest rate that you pay on your mortgage will be higher than the rate of interest that you receive on your savings;

- Secondly, the interest that you receive on your savings is taxed, whereas you do not get a tax deduction for the interest that you pay on your mortgage; and

- Thirdly, if you keep the same capital repayment each month, you will pay off your mortgage more quickly, which will result in savings of interest towards the end of the mortgage.

ILLUSTRATION

If you are a higher rate taxpayer and you have;

- *£20,000 in a deposit account on which you receive interest of 2.5%, and*

- *a mortgage of £100,000 on which you pay interest rate at 5.5%,*

you will immediately be £800 a year better off (in interest terms) if you use the balance on your deposit account to reduce your outstanding mortgage.

This is a sound financial Tip, that results in some tax saving.

TIP	Pay down your mortgage with savings		
SAVE	£1,000's	**EASE OF USE**	Simple

9.3 Renting out property

To start off with, we need to explain some basics;

- You are taxed on the **profits** that you make from renting out property. These profits are defined as rental income less any allowable (or tax deductible) costs.

- The amounts that you report in your Tax Return are grouped into four categories;

  - Hotels, Guest Houses and "B&B"s

  - Furnished Holiday Lettings in the UK

  - Other property in the UK

  - Overseas property

- These categories are reported differently in your Tax Return;

  - The first category (Hotels, Guest Houses, B&Bs) is reported on the Self Employment pages of the Tax Return (if you run the business as a sole trader or partnership) or the Employed pages (if you run the business as a limited company),

- o The second and third categories are reported separately on the “Land and Property” pages of your Tax Return, and
  - o The fourth category (Overseas Property) is reported on the “Overseas” pages of your Tax Return.

- The profits that you report in your Tax Return, and hence pay tax on, are those that you make **in the tax year**. It is important that people in the business of renting property understand this fact as, if they are a sole trader or partnership, and they produce their accounts to a date other than 31st March to 5th April, they will be required to apportion figures from two sets of accounts in order to calculate what should go in their Tax Return

- As far as UK properties go;

  - o Profits from Hotels, Guest Houses etc are treated as **trading income**,
  - o Profits from “Furnished Holiday Lettings” are treated as **trading income**;
  - o Profits from “Other property” are treated as **investment income**,

  The distinction between “trading income” and “investment income” is very important. We explain why this is important in 9.3.4 below.

- If you own UK property, you will pay UK tax on the profits that you make from this property, **regardless** of whether you are resident in the UK or not

- If you own overseas property, you will only pay UK tax on the profits that you make from this property **if** you are resident in the UK for tax purposes (see Section 17)

OK, so having established the basics, lets now turn to the Tax Saving Tips.

These Tips are set out as follows;

Section	Refers to
9.3.1 to 9.3.3	**All** rented property
9.3.4 to 9.3.7	“Furnished Holiday Lettings”
9.3.8 to 9.3.10	“Other Property”

9.3.1 Rental income

If you rent out a property owned by you, your Tax Return must include details of all the income that you were entitled to receive for the tax year, even if you hadn't received it in cash by 5th April. This is called the “accruals basis” for recognising income.

If you have not received some rental that was due to be received in the tax year, despite your taking appropriate steps to try and recover it, you should include it as part of your rental income, but you should also claim a tax deduction for a bad debt of the same amount.

TIP	Claim a tax deduction for bad debts where you have been unable to collect rents due to you		
SAVE	£1,000’s	**EASE OF USE**	Simple
What you need to do	Include the value of your bad debts in box 5.29 of the Land and Property pages of your Tax Return		

9.3.2 Energy saving allowances/deductions

Landlords can claim a **tax deduction** for 100% of the cost of installing loft or cavity wall insulation in dwellings that they let, up to £1,500 per property. If you claim this deduction, you cannot claim a capital allowance for the same expenditure.

From 6 April 2006, Landlords can also claim a tax deduction for 100% of the cost of draught proofing and insulation for hot water systems.

TIP	Claim an immediate tax deduction for energy-saving costs		
SAVE	£100's	**EASE OF USE**	Simple

9.3.3 Pay your spouse and children

You should consider paying your spouse and/or your children for doing the cleaning or the gardening at the properties that you let.

Any amounts that you pay will be tax deductible, which would not be the case if you did the work yourself. However, they must actually do the work and be paid for it at a reasonable rate!

In order for this arrangement to save you tax, your spouse and children must have "unused" tax allowances i.e. they must be earning less than the value of their tax allowances (see also 8.14).

TIP	Pay your family for work that they do for you and claim a tax deduction for it		
SAVE	£100's	**EASE OF USE**	Simple
CONSIDER	You should only pay family members that are taxed at a lower rate than yourself.		

9.3.4 to 9.3.7 below refer only to Furnished Holiday Lettings.

9.3.4 Furnished Holiday Lettings

As we have explained, when you fill in your Tax Return, you are required to distinguish between Furnished Holiday Lettings in the UK and all other rented property in the UK;

- The income and allowable (tax deductible) costs of all of your **furnished holiday lettings** are accumulated for the tax year and reported in boxes 5.1 to 5.18 of the Land and Property pages of the Tax Return.

- The income and allowable (tax deductible) costs of all of your **other property** are accumulated for the tax year and reported in boxes 5.19 to 5.37 of the Land and Property pages of the Tax Return.

So, what are "furnished holiday lettings"?

To qualify as furnished holiday lettings, the accommodation must satisfy the following conditions **for the 12 months covered by the tax year**:

- be **furnished and let on a commercial basis**, with a view to making profits,

- be available for letting to the public on a commercial basis as holiday accommodation for periods of **at least 140 days** in total,

- **not be occupied by the same person for more than 31 days during at least seven months of the year** (although that person can occupy the property for the remaining 5 months),

- **be let for at least 70 days** in total. If there are several holiday letting units which all satisfy the 140 day and seven month rules, then actual lettings for all units can be averaged to satisfy the 70 day rule.

The property need not be in an acknowledged holiday resort and the tenants do not actually have to be on holiday.

Any rented property that does not qualify as “Furnished Holiday Letting” is classified as “Other Property”.

There are **five main tax advantages** of “Furnished Holiday Lettings” compared to “Other Property”, which arise from the fact that “Furnished Holiday Lettings” are treated as a business (and any profits that you make are treated as “trading income”). These advantages are as follows;

- you can offset tax losses from the “furnished holiday lettings” business against **all other taxable income** that you have **in the tax year**, **or the previous tax year** (see 8.19 for an explanation of what you can do with business losses), whereas with “other rented property” you can only carry the losses forward for offset against future taxable profits of the same business,

- you are allowed to **claim capital allowances** on purchases of furniture, furnishings and equipment (capital allowances are explained in Appendix 4 and 8.13), whereas you are not allowed to claim any capital allowances for expenditure on other rented property,

- the profits of the “furnished holiday lettings” business are included in the calculation of “**net relevant earnings” for pension purposes**, which will increase the amount of tax-free pension contributions that you can make (see 18.3 for a full explanation of this), whereas the profits from other rented property are not included in “net relevant earnings” ,

- you are able to **defer any Capital Gains Tax** that is payable when the property is sold by using rollover, holdover or retirement relief (see Section 19 on Capital Gains Tax for an explanation of these terms),

- the property qualifies for business asset taper relief under Capital Gains Tax rules (see Section 19) and for business property relief under Inheritance Tax rules (see Section 20).

Because of these very attractive tax advantages, it is very much in your interest to make sure that your rented properties are classified as “furnished holiday lettings” if at all possible.

TIP	Where possible, get rental property classified as “furnished holiday lettings” and use this to your advantage in; • claming relief for business losses against all of your taxable income in the current or previous tax year • claiming capital allowances on asset purchases • making tax-free pension payments; and • claiming a deferral of any Capital Gains Tax due on the sale of rental property		
SAVE	£1,000’s	**EASE OF USE**	OK
What you need to do	Make sure that your rental properties meet the conditions for “furnished holiday lettings” described above and, in particular, make sure that; • you do not occupy them for more than 5 months in any one tax year, and • they meet the 70-day occupation rule		

9.3.5 Capital allowances

You can claim capital allowances for the costs of;

- Furnishing and equipping property;

- Equipment that you need to run the business (such as computers, lawnmowers, desks, telephones etc).

But if you do so, you **cannot** claim the cost of renewals as a tax deductible expense (see Figure 16 below).

Claiming capital allowances will generally be more beneficial than claiming a tax deduction for the cost of renewals, as you will be able to claim capital allowances when you **buy the items in the first place**, whereas you will only be able to claim a deduction for the cost of renewals when you **replace** them items.

TIP	Claim capital allowances on capital expenditure		
SAVE	£1,000's	**EASE OF USE**	Simple
What you need to do	Keep accurate and detailed records of work undertaken Do not claim a tax deduction for the cost of renewals and replacements – capital allowances are claimed instead.		

9.3.6 Allowable expenses for furnished holiday lettings

Figure 16 below summarises the type of expenditure that you can deduct from your income when you are calculating the taxable profits of your **furnished holiday lettings** business.

Figure 16. Allowable holiday letting expenses

Category of Expenditure	Examples
Rent, rates, insurance, etc	• Rent • Buildings and contents insurance • Business rates • Council tax • Water rates • Ground rents • Gas • Electricity
Repairs, maintenance and renewals	• Repairs *(but see 9.3.7)* • Maintenance*(but see 9.3.7)* • Painting • Decorating • Renewing moveable objects, such as furniture, appliances *(but see 9.3.5)*
Finance charges	• Interest on loans to buy the property or develop the property, or alternatively to repay an existing loan taken out for one of these purposes (but excluding any capital repayment of those mortgages) • Fees in arranging the loans • Bank charges • Overdraft interest on a business account
Legal and professional fees	• Accountants fees • Agency fees for managing a property, drawing up an inventory, collecting rent etc • Legal fees – for drafting lease agreements, or evicting a tenant
Costs of services	Services such as; • Cleaning • Laundry • Gardening etc *but not if you do the work yourself*
Other expenses	• Advertising • Stationery • Telephone and fax • Postage • Travel costs solely for business purposes

This expenditure must be incurred "wholly and exclusively" on the business in order to be tax deductible.

If you use a property partly for your own holidays, you will only be able to claim a tax deduction for the "business proportion" of these expenses.

ILLUSTRATION

If you spend one month every year at a property for your own holidays, you will only be able to claim a deduction for 11/12 of the expenses that relate to that property.

TIP	Claim a deduction for all business expenses in connection with your furnished holiday lettings		
SAVE	£1,000's	**EASE OF USE**	OK
What you need to do	Restrict the deduction when you use a property for private holidays		

9.3.7 Repairs and Improvements

If you undertake repairs and improvements **together** you will not get a tax deduction for this cost **unless** the improvement has been done in order to comply with modern building standards (such as the installation of central heating, double glazing, or insulation).

If you do not get a tax deduction, you will be able to claim capital allowances on the costs of any improvements, **but only if these can be separately identified**.

You should therefore keep good records of any maintenance and up-grading work that you undertake, and, where possible, get the costs of "repairs" and "improvements" invoiced separately.

TIP	Claim a deduction for the costs of repairs and improvements		
SAVE	£100's	**EASE OF USE**	Simple
What you need to do	Keep accurate and detailed records of work undertaken Get repairs and improvements invoiced separately		

Having described how to save tax in connection with Furnished Holiday Lettings, let us now turn to the other category of UK property – "Other Property".

9.3.8 "Other property"

"Other property" means all of the UK property that you rent out that does not meet the definition of "Furnished Holiday Lettings".

The income and allowable (tax deductible) costs of all of your "**other property"** are accumulated for the tax year and reported in boxes 5.19 to 5.37 of the Land and Property pages of the Tax Return.

All the expenses that are allowed as tax deductions for **Furnished Holiday Lettings** (see Figure 16 above) are also allowed as deductions for "**other property**".

TIP	Claim a deduction for <u>all</u> allowable expenses		
SAVE	£1,000's	**EASE OF USE**	OK
What you need to do	Keep records so that you can identify all of the costs that you have incurred in renting out your property		

However, **no capital allowances** are allowed for the cost of making improvements to property or replacing fixtures, fittings and furnishings in "**other property**".

If you rent out **furnished property**, you can claim a tax deduction for expenditure on furniture and fittings on one of two bases;

- Either by claming a tax deduction for the actual cost of **renewing and replacing** the furniture and fittings (but not for the initial cost of buying it in the first place), or

- By claiming a "wear and tear allowance". This allowance is calculated as 10% of a sum, that sum being calculated as the rent receivable less amounts payable by you for water rates and council tax.

Most landlords use the "wear and tear" method, as;

- it provides an immediate tax deduction in the year that letting begins,

- it is easy to calculate and,

- it is generally accepted that it gives a higher overall tax deduction than the alternative method, for all but the most ostentatiously furnished property.

Once you have used one method for claiming a tax deduction on renewals, you cannot change.

TIP	Use the "wear and tear" method for claiming a tax deduction for the cost of furnishing and fitting out your property.		
SAVE	£1,000's	**EASE OF USE**	OK

9.3.9 Rental losses

If you make a loss from renting "**other property**" in a tax year, you are only allowed to carry this loss forward and set it against the profits that you make from renting "other property" in future. **You cannot offset these losses against your other income**.

You do not need to make an election for losses to be carried forward – it is done automatically.

If you stop letting and there is a gap before you begin letting again, you may not be able to carry forward any earlier losses.

In order to keep earlier losses, you will need to demonstrate to the Revenue that there were good reasons why your property was not let. These reasons include;

- Your property was being refurbished,

- Your property remained available for letting throughout the period, but you could not find tenants (you will need to be able to show that you were looking for tenants during this period)

TIP	If you are carrying forward losses, and you have every intention of renting out property in the future, do not lose these losses as a result of periods during which your property is not rented.		
SAVE	£1.000's	**EASE OF USE**	Simple
What you need to do	Make sure that you can show that you carried on marketing your property when it was not let, or, if you did not market it, that this was because you were refurbishing or renovating it.		

9.3.10 Rent a room

Rent a room relief

If you rent out a furnished spare room in your only or main home, the rental income is tax-free up to a limit (£4,250 per annum for 2005/06 and 2006/07). This is called “rent a room” relief.

This applies to houses, flats, caravans and even houseboats.

You can **elect** not to receive this form of relief, and **instead** be taxed under the normal rules that apply to the rental of “other property” (see above). In broad terms, this would mean that you would be taxed on the rental income less any “allowable” expenses.

You will therefore need to do a calculation at the end of each year, to decide which option is the best for you.

In general, you should not claim “rent a room” relief if the allowable (or “tax deductible”) expenses related to the renting are greater than the rent-a-room relief (currently £4,250).

The type of expenses that you can claim as deductible are discussed in the next Tip below.

EXAMPLE

Jane Johnson lets out a room in her house for £400 a month. She incurs £1,250 of allowable expenses that can be set against this income. Jane is a basic rate taxpayer.

If she makes use of the rent-a-room relief, her tax liability will be £121, calculated as follows;

(£4,800 – £4,250) x 22% = £121

If she is taxed under the normal rules that apply to the letting of furnished property, her tax liability will be £781, calculated as follows;

(£4,800 - £1,250) x 22% = £781

By claiming rent-a-room relief, Jane will save £660 of tax.

TIP	Consider claiming “rent a room” relief		
SAVE	£1,000’s	**EASE OF USE**	OK
What you need to do	At the end of each tax year you will need to calculate whether you will pay less tax by claiming rent a room relief or by claming a deduction for allowable expenses. You should complete your Tax Return using the method that gives you the lower tax bill.		

Get your lodger to pay for some bills

If you are claiming “rent a room relief”, but you are charging your lodger rent of more than £354 a month (being £4,250 divided by 12), you will pay tax on the excess.

If you are also paying the cost of certain bills, why not get the lodger to pay these bills separately and, in return, bring down the rent charge to less than £354 a month?

By doing this, you will not pay any tax.

TIP	Reduce your tax bill by getting your lodger to pay some bills directly and, in return, reducing the rent that you charge		
SAVE	£100’s	**EASE OF USE**	Simple

Deductible expenses when “renting a room”

Instead of claiming a "rent a room" relief, you can claim a tax deduction for a proportion of the following "allowable" expenses if you are renting a room in your home;

- gas and electricity
- insurance premiums for buildings and contents
- maintenance and repair costs (but **not** the costs of improvements)
- water rates
- rent, if you do not own the property
- advertising costs (for a tenant)
- the fees an agent charges to let your home for you, and
- council tax which you pay for the let property.

ILLUSTRATION

If your house has four bedrooms and three reception rooms, and you rent out one bedroom, you can claim;

- *one-seventh of the expenses incurred on the whole house, **plus***
- *the full amount of the expenses incurred **solely** on the let part of the house, such as the cost of advertising for tenants*

TIP	Claim a tax deduction for all allowable expenses if you are renting out a room in your home, if this is more than the "rent a room" relief described earlier		
SAVE	£100's	**EASE OF USE**	Simple
What you need to do	You will need to keep full records of the costs listed above, so that you can calculate the proportion of these costs that you can claim as a tax deduction. You will need to include these costs in Boxes 5.24 to 5.29 the Land and Property pages of your Tax Return.		

Pre-trading expenditure when "renting a room"

If you incurred costs in the seven years before you rented out a room, and these costs would have been deductible for tax purposes had you already started trading, you can treat them as being incurred in the first year of trading.

For example, advertising costs incurred in looking for a tenant, or costs paid to an agency for drafting up a tenancy agreement, are deductible expenses even if they were incurred in the tax year before the one when you started to receive rent.

TIP	Claim a deduction for costs incurred before you started renting out a room.		
SAVE	£100's	**EASE OF USE**	Simple
What you need to do	Include these costs in Boxes 5.24 to 5.29 of the Land and Property pages of your Tax Return.		

9.4 Tax-free property ownership in your pension fund

From 6th April 2006, your pension fund can own ***commercial*** property. NB: Your pension fund cannot own any form of ***residential*** property (including buy-to-let property).

Commercial property includes shops, offices, factories, hotels, motels, pubs, leisure facilities, and even agricultural land and bare land, on a freehold or leasehold basis. In fact, roughly everything except residential property!

The only instance where residential accommodation is likely to qualify is where it is ancillary, such as caretaker's accommodation.

Your pension fund is also allowed to borrow a maximum of 50% of its value to purchase assets, including commercial property. As income and capital gains earned by a pension plan are earned tax-free, this change will open up a valuable tax saving opportunity. For example;

- Your pension plan can own your business premises and rent them back to your business. Any rent that your business pays is a tax-deductible cost in its/your tax return, but your pension does not pay tax on the rental income. Also, the rent received by your pension does not count towards the annual pension contribution limits described in more detail in paragraph 18.17 below.

There are two restrictions of which you need to be aware;

- Any income and gains that are earned by your pension plan in this way will be "locked in" to the pension plan until you are 50. Until then, you will not be able to access them for your own use.

- The value of your pension plan as a whole is not allowed to exceed £1.5 million.

Despite these restrictions, this is a very attractive way of taking advantage of rising property prices and saving tax at the same time!

TIP	Get your pension plan to invest in property		
SAVE	£10,000's	**EASE OF USE**	Difficult
What you need to do	Consult with an IFA.		

9.5 Other relevant Tips elsewhere in this Guide

- Buying accommodation for a child (see 5.5)

- Your Home (see 19.16)

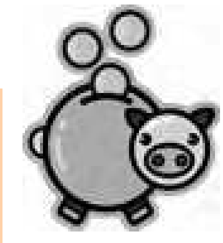
- Lettings exemption (see 19.17)

- Lodgers (see 19.18)

- Council Tax (see 21.1)

10 PEOPLE WITH SAVINGS AND INVESTMENTS

You should read this Section if you have savings or investments, or if you expect to have some in the next 12 months.



In this Section you will learn;

- **How you can save for your future and pay no tax on any income or gains that you earn**
- **Of a lottery where you win tax-free prizes and get your stake money back, win or lose!**
- **How you can save for your retirement, get the Government to contribute <u>and</u> save tax**
- **About Enterprise Investment Schemes and Venture Capital Trusts – tax saving for the rich and famous!**
- **How a married couple can save up to £1,900 in tax just by transferring assets between themselves**
- **Why you will pay much less tax if you invest in commercial property rather than residential property**

10.1 Individual Savings Accounts

Individual Savings Accounts are one of the best ways of saving tax.

An Individual Savings Account (or "ISA") is simply a special type of savings and investment account, which is virtually immune from tax.

You can imagine the ISA as a safe, to which the Inland Revenue is not allowed to know the combination, thus allowing any money that is kept inside it to be completely safe from tax.

An ISA isn't an investment in itself, it is just a "safe" (or a "wrapper") into which you put your savings or investments.

ISAs offer tax-free saving in the following areas (or "components");

- Cash
- Stocks and shares
- Some life insurance policies

Lets look at each in turn:

- You can save **cash** inside an ISA and the interest will be **tax-free**;
- You can invest in **stocks and shares** in an ISA and;
    - **capital gains (or capital growth),** which means an increase in the price (or value) of the investment, will be **tax-free**;
    - **dividend income** from shares **<u>is</u>** taxed, but only at the basic rate (as the 10% tax that is deducted at source on dividends cannot be reclaimed by ISA Managers). This means that:

- basic rate taxpayers will **not save tax** on dividend income by investing in shares in an ISA,

- higher rate taxpayers **will save tax** on dividend income from investing in shares in ISA as no higher rate tax is payable on dividend income earned within an ISA.

  - **interest income is not taxed**. So, investing in corporate bonds or cash-based unit trusts through an ISA is tax advantageous, as interest income will be received tax-free.

- You can invest in certain **life insurance products** in an ISA and the benefits that accrue on those products will be tax-free.

You **do not** get a **tax deduction** for money that you put **into** an ISA. So, if you invest £3,000 in an ISA in 2006/07, this is not a "cost" that you can deduct in arriving at your taxable income for 2006/07.

You **do not** get **taxed** on the money that you take **out** of an ISA. So, if you take £3,000 out of an ISA in 2006/07, this is not "income" that you have to add in arriving at your taxable income for 2006/07.

ISAs are managed by an "ISA Manager", which will normally be a bank, a building society or an investment company.

You can withdraw your money at any time from an ISA, **unless** the ISA Manager has imposed a minimum investment period and this period has not expired.

You will pay charges for using an ISA, but you will benefit if the charges that you pay are less than the tax that you save from using an ISA.

TIP	Put money into an ISA		
SAVE	£1,000's	**EASE OF USE**	Simple
What you need to do	Decide what you want to invest in (or, if you don't know, speak to an IFA) Decide how much you want to invest (up to the allowed limits – see 10.1.1 below) Open an ISA, by approaching an ISA Manager yourself, or by getting an IFA to do it. You will need to fill in a few forms to get the ISA started and **always** make sure that you understand what fees and charges you are paying before you sign the forms.		

10.1.1 Maximum annual ISA allowance

You can invest up to £7,000 each year in an ISA in 2004/05, 2005/06 and future tax years through until at least 2010.

You are not allowed to draw money out and then put money back in – you can put in up to £7,000 in a tax year and that's it. At that point you've used up your ISA allowance for that year.

This means you need to make sure, wherever possible, that you don't put in money that you might need soon afterwards, otherwise you will waste some of your annual "ISA" allowance.

TIP	Whenever possible, use up all of your maximum annual ISA allowance over the course of the tax year. Where this is not possible, use up as much of it as you can!		
SAVE	£1,000's	**EASE OF USE**	Simple
What you need to do	Rather than wait until near the end of the tax year and then discover that you can't afford to put any money into an ISA, why not set up a small monthly payment that you can afford (of maybe £100 or £200 a month) and then supplement this with one-off payments during the year if you start to build up savings that you do not need?		

10.1.2 Types of ISA

There are **two basic types of ISA** – the "**Maxi ISA"** and the "**Mini ISA"**. Each has three parts, and the financial investment in each part is limited:

- Cash – maximum £3,000
- Shares – maximum £3,000
- Insurance – maximum £1,000

Don't start to glaze over. This is important.

The difference between the Maxi ISA and the Mini ISA is that with the Maxi ISA you choose one company ("ISA Manager") to run all three parts of the ISA, whereas with a Mini ISA you can choose a different company to run each part.

The Mini ISA gives you greater flexibility of choice. For example, if one company is offering great interest rates on their Cash Mini ISA, but you don't like the charges on their Shares Mini ISA, you can open their Cash Mini ISA and go to someone else for your Shares Mini ISA.

There is one special rule that applies to Maxi ISAs that the Government have introduced to encourage share ownership; if you want, you can put your entire £7,000 allowance just into the shares part of a Maxi ISA. This does not apply to Mini ISAs. However, remember that basic rate taxpayers do not save tax on dividend income earned in an ISA.

You are only allowed to take out one type of ISA each year. So, if you open a Maxi ISA this year you cannot also open a Mini ISA as well. It's one or the other - until the next tax year when you're allowed to either continue with what you've already got, or start afresh.

It's entirely up to you whether you opt for a Maxi ISA or a Mini ISA.

- The **Maxi ISA** is generally advisable for people who have larger sums to invest (over £3,000) and who have some knowledge of the stock market, as it allows them to put all of their ISA allowance into shares. It is also more attractive for higher rate taxpayers, as they will not pay higher rate tax on dividend income.
- The **Mini ISA** is probably better if you are thinking of investing less than £3,000, as you are then free to find the best interest rate for the cash component of your ISA.

TIP	Select the type of ISA that you invest in according to; • how much you are willing to invest, • whether you want to invest in shares, and • whether you are a higher rate taxpayer or not.

10.1.3 Invest in ISAs every year

When a new tax year starts, you can choose to pay into the same ISA as before, or you can open a different ISA.

Your original ISA from the previous tax year will continue, protected from tax, until you decide to withdraw your cash or investments.

However, you won't be able to add any more money to your old ISA in the new tax year **<u>if</u>** you open a new ISA - you can only contribute **to one ISA** in any one tax year, however many ISAs you have open.

TIP	Invest in ISAs **every** year – don't make it a one-off event		
SAVE	£1,000's	**EASE OF USE**	Simple
What you need to do	Be disciplined. Work out amounts that you can put into your ISA(s) regularly (monthly or quarterly) and stick to it. Shop around. At least once a year, look at the various types of ISA on the market (and/or meet your IFA). See what takes your fancy. Spread your risk. It is good practice not to "put all of your eggs in one basket", so we suggest that you look to build up a selection of different ISAs with different ISA Managers. Also, if you want to invest in equities, invest in funds rather than in individual shares.		

10.1.4 What to invest in

This is very important: Putting money in an ISA will save you tax, but it is **what you invest in** that will determine **how much you earn tax-free**. Your choice of ISA is therefore critically important. Because of this, we recommend that you should always take advice from an IFA before investing in an ISA.

TIP	Take professional advice

10.1.5 When to invest

Research has shown that a large proportion of the money out into ISAs is invested in the last few weeks of the tax year, as people try to use up their annual ISA allowances.

For share ISAs, it makes much more sense to invest the money steadily over the course of a year, as this reduces the chance that you will buy shares when their price is high because of a temporary peak in the stock market.

You should look for schemes which allow you to invest by direct debit on a monthly or quarterly basis.

TIP	Invest gradually and regularly throughout the year

10.1.6 Move current investments into an ISA

If you already have money tied up in investments, and you have not used up your ISA allowance for the tax year, you can arrange to have your investments (up to a current value of £7,000) transferred immediately into a Maxi ISA.

Once transferred, all income and capital gain on your investments will then be tax-free. If left outside an ISA, all income and gains will be taxed at your highest rate of tax.

The income and capital gains that a higher rate taxpayer receives on these investments will be **67% higher** if the investments are held in an ISA.

This is an easy-to-implement and very tax efficient Tip.

TIP	Move current savings or investments into an ISA		
SAVE	£1,000's	**EASE OF USE**	OK
What you need to do	Talk to your bank or an IFA about transferring current investments in this way. In this instance, you are not looking for your ISA Manager to provide any investment advice or expertise, you are just looking for someone to provide the "safe" into which you can put your existing investments. Given this, you should select your ISA Manager based purely on the level of their charges. Shop around and compare charges.		

EXAMPLE

Rio Neville invested the following amounts in ISAs;

6/4/2003 *£3,000 in a Mini ISA with Lloyds TSB earning fixed interest at 4.25%, with no charges*

6/4/2004 *£7,000 in a "shares" Maxi ISA – a "European Growth ISA" managed by Fidelity – when the units were priced at £5.50 each. The ISA has an initial charge of 1% and an annual charge of 1.25%. The ISA pays guaranteed annual dividends of 1.5%, with half being paid on 1st May and the other half being paid on 1st December*

6/4/2005 *£3,000 in a Mini ISA with "Smile", paying 4.50% interest, with no charges*

Rio withdrew £1,500 from his Lloyds TSB Mini ISA on 6th October 2005.

Rip sold his Fidelity Maxi ISA on 5th April 2006 when the units were valued at £6.50.

Since 6th April 2003, Rio will have received the following income tax-free;

2003/04 *Interest of £127.50 on the Lloyds TSB Mini ISA*

2004/05 *Interest of £127.50 on the Lloyds TSB Mini ISA*
Dividends of £105.00 on the Fidelity Maxi ISA

2005/06 *Interest of £95.62 on the Lloyds TSB Mini ISA*
Dividends of £105.00 on the Fidelity Maxi ISA
Interest of £135.00 on the Smile Mini ISA
£8,027.73 on the sale of his Fidelity ISA[12]

He will therefore have received a total of £8,723.35 over this period, £7,000 of which is effectively the repayment of his initial investment in the Fidelity ISA.

His net return over the 3 years is therefore £1,723.35, all of which has been received free of any tax.

Rio will not pay tax on the withdrawal of cash on 6th October 2005.

[12] After taking account of the following charges;
2004/05 £157.50 (being 2.25% of the cost of the investment) and
2005/06 £87.50 (being 1.25% of the cost of the investment).

10.2 Friendly Society Accounts

These accounts are tax-free and are normally recommended as a tax efficient means of saving, especially for children.

They normally involve a regular monthly saving of up to £25 a month into a “with profits” endowment policy, with all returns received tax-free.

The theory is fine, but in practice they tend to generate very low returns because the charges are high.

By all means, shop around to see if you can find any Friendly Society accounts with low charges, but in our view there will be many better alternatives for your savings.

TIP	Consider Friendly Society accounts as a means of earning money tax-free, but be very wary of their charges.		
SAVE	£100’s	**EASE OF USE**	Simple
CONSIDER	Other investments (see below) typically offer better returns		

10.3 Children’s National Savings Bonus Bonds

Children's National Savings Bonus Bonds last for five years and can be bought in units of £25 up to a current maximum of £3,000 per child.

They enable you to invest for a child, in their own name.

The Bonds are available in separate “issues”, which have their own fixed interest rate and investment limit. Each time a new issue comes out, you can invest up to the limit, tax-free.

They currently[13] pay an effective annual interest rate of 3.85%, which is made up of 2.95% each year for five years with a bonus at the end of 5.16%.

There are three good things about them;

- Firstly, the bonds are **backed by the Government**, so there is no chance of you losing your money,
- Secondly, all **interest is received tax-free**, and
- Thirdly, they are **easy to buy** – just go to the Post Office and ask for a form.

At the end of the investment period, you can leave the Bond earning a new tax-free rate of interest for a further five years, or until the child is 21, when a final bonus is added. And if the child starts work and becomes a taxpayer before cashing in their Bond, this makes no difference - the interest and bonuses remain tax-free.

TIP	Consider investing in Children’s National Savings Bonds to receive tax-free income		
SAVE	£100’s	**EASE OF USE**	Simple
What you need to do	Go to the Post Office and ask for a form or call 0845 964 5000. Decide how much you want to invest and return the completed form and a cheque to National Savings and Investments by post or via a Post Office		

[13] On the date of writing. May 2006.

10.4 National Savings Certificates

The Government allows you to invest a large amount of money in National Savings Certificates and receive money on these investments tax-free. Each person's permitted investment is;

- £15,000 per person in each of the three and five year **Index-Linked** Savings Certificates; and
- £15,000 per person in each of the two and five year **Fixed Interest** Savings Certificates;

The returns are not fantastic, but you do have the security of knowing that the investments are **backed by the Government** and that you therefore have **no risk** of losing your money.

The Index-Linked certificates pay an interest rate based on the retail price index (RPI), which is currently RPI plus 0.90% on the three-year certificate and RPI plus 0.95% on the five-year certificate. The RPI in April 2006 was 2.4%, so these interest rates equated, at that time, to 3.3% and 3.35%.

The Fixed Interest certificates pay a fixed rate of interest, which is currently 3.05% on the two-year certificate and 3.05% on the five-year certificate.

And remember this interest is **tax-free**. In order to get a better after-tax return from an investment that produces *taxable income*, a basic rate taxpayer would need to find an investment paying an interest rate of more than 4 to 4.5% and a higher rate taxpayer would need to find an investment paying an interest rate of more than 5% to 6%.

The certificates are not automatically cashed in at the end of their term. As a result, many people continue to hold them beyond their normal redemption date. **This is not advisable**, as the interest rate paid after the redemption date is generally very low.

Make sure that you cash in your certificates at the end of their term and, if necessary, re-invest the proceeds into a new issue of National Savings Certificates.

TIP	Consider buying National Savings Certificates, particularly when the Bank of England base rate is at a low level		
SAVE	£1,000's	**EASE OF USE**	Simple
What you need to do	To buy National Savings Certificates, you can either; • call 0500 500 000 with a debit card; or • complete an application form available at any Post Office branch and buy; o over the counter with cash or cheque, or o by post direct from National Savings and Investments by sending a cheque		

10.5 Premium Bonds

Gambling on the National Lottery (or Lotto as it is now known) is very popular, but the chances of winning anything are incredibly small.

But what would you think if we told you that you could;

- Enter into one of the country's state-backed lotteries
- Buy as many tickets as you could afford, offering tax-free prizes of up to £1 million, and
- Get **all of your money back whenever you like** – even if you win!

Well, this is the case with Premium Bonds! In essence, if you hold Premium Bonds, you are entering a lottery where you simply can't lose.

The overall chances of winning are greater than Lotto, there's no need to fill out an application every week, the prizes are tax-free and they arrive by cheque in the post. It's simple, straightforward and effectively free to enter.

The Government allows each person to invest up to £30,000 in Premium Bonds.

As with National Savings Certificates, your investment is secure as Premium Bonds are backed by the Government. You have no risk of losing your money.

The organisation that administers Premium Bonds (National Savings & Investments) says that someone who buys £30,000 of premium bonds can expect to receive 15 £50 prizes every year. That works out to a return of 2.5%.

This does not seem like much but, for a higher rate taxpayer, this is the equivalent of a taxable investment that is paying gross interest of 4.2%. On top of that there is the chance for bigger prizes, which takes the average return to 2.9%, or 4.6% for higher-rate taxpayers.

In times of low inflation, low interest rates, and under performing stock markets, Premium Bonds are an attractive investment, and they are certainly a much better alternative than Lotto!

<table>
<tr><td>TIP</td><td colspan="3">Consider buying Premium Bonds, particularly when the Bank of England base rate is at a low level</td></tr>
<tr><td>SAVE</td><td>£1,000's</td><td>EASE OF USE</td><td>Simple</td></tr>
<tr><td>What you need to do</td><td colspan="3">To buy Premium Bonds, you can either;
• call 0500 500 000 with a debit card; or
• complete an application form available at any Post Office branch and buy;
  o over the counter with cash or cheque, or
  o by post direct from National Savings and Investments by sending a cheque</td></tr>
</table>

10.6 Other National Savings and Investments products

The following NS&I products pay income gross (with **no tax** deducted at source);

- Investment Account,
- Easy Access Savings Account,
- Income Bonds,
- Guaranteed Equity Bonds, and
- Pensioners' Guaranteed Income Bonds.

The income ***is* taxable**, but the benefit is in the fact that you will not have to pay the tax until 31st January after the end of the tax year in which you received the income (for the first year, at least). This may effectively delay your tax bill on this income for as much as 22 months.

<table>
<tr><td>TIP</td><td>Delay the payment of tax on investment income by buying the NS&I products listed above.</td></tr>
<tr><td>CONSIDER</td><td>There is no real tax saving from buying these products, and you should only invest in them if you cannot find alternative investments that will provide you with a higher after-tax return for an acceptable level of risk.

We suggest that you <u>do not buy</u> NS&I Capital Bonds, as the income on this product is “accumulated” and only paid out at the end of its 5-year “term”, but you will still be taxed each year on the income that you have earned.</td></tr>
</table>

10.7 "Current account" or "offset" mortgages

A current account, or offset, mortgage, works like a big overdraft and can provide significant tax savings. This is best illustrated by way of example;

EXAMPLE

Anna Brown has £1,500 in a current account, on which she earns no interest, £10,000 in a savings account, on which she earns interest at a rate of 2.5% and an interest-only mortgage of £70,000, on which she pays interest at a rate of 5%.

Anna will receive annual interest of £200, being £250 less tax of 20% deducted at source, and she will pay mortgage interest of £3,500.

Overall, she will pay out a net amount of £3,300 per year (assuming that she is a basic rate taxpayer).

If she had a "current account" or "offset" mortgage, all of her money would be in one account, giving a net "overdraft" of £58,500 (being a mortgage of £70,000 less cash of £11,500).

Assuming the same mortgage interest rate, this would result in an annual interest cost of £2,925, providing a cash saving to Anna of £375 a year, £50 of which comes from not having to pay tax on interest received.

The arrangement works well as it is effectively the same as earning income tax-free on your positive cash balances at the mortgage interest rate (which is always higher than the interest rate on savings).

<table>
<tr><td>TIP</td><td colspan="3">Get a "current account" or "offset" mortgage</td></tr>
<tr><td>SAVE</td><td>£10,000's</td><td>EASE OF USE</td><td>Simple</td></tr>
<tr><td>What you need to do</td><td colspan="3">Shop around. Ask your existing mortgage company whether they do "current account" mortgages and look in the newspapers for others. You might also ask an IFA to recommend a couple of companies that are offering these mortgages.

Compare the interest cost of each mortgage and play one company off against the other. You will be surprised how "flexible" some companies can be when it comes to interest rates, particularly the one that is providing you with your current mortgage.

Try to minimise the other costs of changing mortgage companies. If you are going to incur penalties as a result of changing, see if your new company will pay these costs.

Also, consider the inconvenience of moving accounts. For example, ask about the procedure for changing direct debits from your current bank account – some companies will help with this, others will not.

Select a new mortgage taking account of all of these factors</td></tr>
</table>

10.8 Pensions

If you are saving for the long-term, and you don't need the money until you are fifty, a pension is **the most tax efficient way of saving**;

- If you are a **higher rate taxpayer**, for every 60p you contribute, the taxman contributes a further 40p.
- If you are a **basic rate taxpayer**, the taxman will contribute 22p for every 78p that you contribute.

The main disadvantage is that the money, once invested, is locked in and cannot be removed until you retire.

This area is explained in more detail in the Section 18 on "Pensions".

TIP	Save for your future by investing in pensions		
SAVE	£1,000's	**EASE OF USE**	OK
What you need to do	See Section 18 on Pensions to understand what you need to do to choose the right pension.		

10.9 Venture Capital Trusts

Venture capital trusts (VCTs) offer one of the best tax breaks available, but they are a risky investment (i.e. the money that you put into them is **not secure**).

VCTs are companies that are quoted on the stock exchange, which invest mainly in other, unquoted, companies.

The idea is that they provide a way for private investors to participate in, and benefit from, the corporate success stories of the future. More than £1 billion has been invested in VCTs since they were launched in 1995.

In terms of tax benefits;

- you get **tax relief** for the investment that you make, as long as you keep the investment for 5 years - although you can sell at any time and forego the tax benefit. The tax relief is 30%. This means that, if you invest £10,000 in a VCT during 2006/07, the tax that you are due to pay on your taxable income in 2006/07 will be reduced by £3,000 because of this investment,

- you only get the tax relief in the tax year that you make the investment,

- there is no income tax to pay on any dividends received from the VCT (although the 10% tax that is deducted at source on dividends cannot be reclaimed),

- there is no Capital Gains Tax to pay when you sell your investment in the VCT.

There is no limit to how much you can invest, but you can only claim **tax relief** on investments of £200,000. The minimum investment in most VCT's is around £5,000.

ILLUSTRATION

A higher rate taxpayer who invested £225,000 in a selection of VCTs during 2006/07, would be able to claim a tax deduction of £60,000 relating to those investments in that tax year.

*This deduction is calculated as 30% of £200,000 (and **not** 40% of £225,000).*

You need to weigh up the very attractive tax benefits against the fact that any VCT investment is very risky. Venture capital is a risky business because, although a handful of companies may turn out to be the stars of the future, many companies never make it.

Because of the risks involved in investing in a VCT, it is generally advised that **you should not invest in VCTs unless**;

- you have already used up your ISA allowance, and

- you have a diversified portfolio of relatively low risk "blue chip" shares, and

- you are an "educated" and experienced investor.

Note: Up until April 2004, you could defer paying tax on a Capital Gain by reinvesting the gain in a VCT. This is no longer allowed. Capital Gains are explained in Section 19.

TIP	For the experienced investor, with a balanced investment and savings portfolio, investing in a VCT is a very attractive way of saving tax. Others should steer well clear!		
SAVE	£1,000's	**EASE OF USE**	Difficult
CONSIDER	High risk		
What you need to do	Speak to an IFA about the many VCTs on the market The tax relief is claimed by completing box 15.3 of your Tax Return		

10.10 Enterprise Investment Scheme

The Enterprise Investment Scheme (EIS) provides similar tax benefits to investors as VCTs.

Under the EIS, you are allowed to invest up to £400,000 a year in unquoted companies.

The major difference to a VCT is that an EIS tends to cover investments by individuals in **specific companies**, whereas a VCT spreads its investment across many companies, thereby spreading the risk.

You **cannot** use this scheme to invest in a company with which you are already "connected", for example as a paid director or shareholder. There are also restrictions on the size of business and the type of business that qualify for the EIS.

The tax breaks of investing through an EIS are:

- **Income tax relief is available at a rate of 20%** up to a maximum investment of £400,000 per tax year, which means that you will get a reduction in your tax bill of £200 for every investment of £1,000:

- You will pay **no Capital Gains Tax**[14] when you sell your investment as long as you hold the shares for at least three years;

- Capital Gains Tax deferral - you can **defer a CGT bill** by reinvesting the gain in an EIS. This tax is then only payable when your EIS shares are sold.

- **Relief for losses**. If your investment goes wrong and you lose money, you can offset the loss that you make[15] against your taxable income in the year of the loss (or the preceding year), or against any taxable gains.

The tax breaks are very attractive and they mean that a higher rate taxpayer is effectively only risking a maximum amount of 60% of his original investment (as a taxpayer gets 20% tax relief in the year that the investment is made and a further 20% tax relief on any loss).

However, like VCTs, EIS investments tend to be very risky. Because of this, it is generally advised that you should not invest in an EIS **unless;**

- you have already used up your ISA allowance, and

- you have a diversified portfolio of relatively low risk "blue chip" shares, and

- you are an "educated" and experienced investor.

TIP	For the experienced investor, with a balanced investment and savings portfolio, investing in an EIS is a very attractive way of saving tax. Others should steer well clear!		
SAVE	£1,000's	**EASE OF USE**	Difficult

[14] See Section 19 for a full explanation of Capital Gains and Capital Gains Tax
[15] This loss must be adjusted for any tax relief that you have claimed on your initial investment

CONSIDER	High risk
What you need to do	Speak to an IFA about EIS The tax relief is claimed by completing box 15.4 of your Tax Return

10.11 British Government gilts

Gilts are bonds issued by the British Government.

A bond is effectively just a loan from the investor to the person or organisation that issues the bond. Someone who invests in gilts is therefore lending money to the Government.

Gilts pay interest (called a "coupon") every six months.

The full amount of the loan (the principal or nominal value) is repaid by the Government on a pre-determined date (the maturity date).

Most gilts pay a fixed rate of interest, but you can also get index-linked gilts where the interest paid and the repayment (or "redemption") amount rise in line with the rate of inflation.

There are no overall tax advantages to buying Gilts, as **the interest is taxable**. However the interest is paid to the investor **gross**, without any deduction of tax at source, and this does therefore provide a cash flow benefit to the investor, between the receipt of the interest and the time when he has to account for the tax due.

TIP	Buy gilts to receive interest without any deduction of tax

10.12 Shares

As we saw in 2.9, the **tax treatment** of **dividend income** (i.e. income from shares) is slightly preferable to **savings income** (i.e. interest);

- Savings income (interest) is taxed at **20%** for basic rate taxpayers and **40%** for higher rate taxpayers, whereas

- Investment income (dividends) is taxed at **10%** for basic rate taxpayers and **32.5%** for higher rate taxpayers.

In simplistic terms, therefore, a share with a 6% dividend yield[16] will leave a taxpayer with a higher **after-tax** income than a deposit account with a 6% interest rate. 12.5% higher in fact.

However, you should not just take into account the dividend yield of a share when deciding whether to invest in a company or not - there are other factors that you will need to take into account, including;

- the risk of the investment,

- the risk that future dividends will be reduced,

- the future capital growth of the share price,

- the costs that you incur in buying and selling shares, and

- your overall Capital Gains Tax position.

The decision is not straightforward. Let's look at an example to illustrate this.

[16] "Dividend yield" is the value of the dividends paid per share divided by the price of the share

EXAMPLE

On 10th April 2005, Wayne O'Connell sold his car for £10,000. He put £5,000 into a savings account earning interest at 3.5% and £5,000 into Pizza Express shares, which had a quoted dividend yield of 3.5%. Wayne is a basic rate taxpayer.

The return on the savings account is always £140 (being £175 gross interest, less tax deducted at source of £35).

Lets look at a few scenarios to see how a variety of influences can affect the overall return that he makes from his investment in shares;

- *If Wayne sold his shares 12 months later at the same price as he bought them for, and the Pizza Express dividend remained unchanged, his investment in shares would have returned £157.50, being the net dividends received during the year. This is higher than the return from his savings account;*

- *If Wayne sold his shares at the same price as he bought them for, but he incurred £50 in costs in acquiring and selling the shares, his net return of £107.50 would be less than the interest from his savings account;*

- *If the Pizza Express shares rose in value by 1% over the year, he paid £50 costs and he had not used up his annual Capital Gains Tax allowance, Wayne would make a net return of £157.50, making the shareholding the more attractive investment;*

- *If the Pizza Express shares rose in value by 1% over the year, he paid £50 costs and he had already used up his annual Capital Gains Tax allowance, the return on his shareholding would fall to £137.50, making the savings account more attractive.*

As this example shows, there are many factors that will affect the after-tax return that you make on investments in shares, and the dividend yield is only one of them.

As a result, you should not base your entire investment strategy on the fact that dividends are treated slightly more favourably for tax purposes than interest.

By all means **bear it in mind** when assessing what to invest in, but also remember to consider the other factors that will influence the money that you make after tax.

TIP	Consider making shares which pay high dividends a small part of your balanced investment portfolio		
SAVE	£100's	**EASE OF USE**	OK
CONSIDER	Risk. Buying shares is one of the riskiest investments, as their value can go down as well as up.		

10.13 Low income earners

A company that pays dividends is required to deduct tax of 10% before paying the dividend to its shareholders.

Non-taxpayers (i.e. those people who do not have sufficient income to use their personal tax allowance) must remember that the tax that is deducted from dividends (called a "tax credit") **is not** repayable, whereas the tax deducted at source from interest income **is** repayable (refer back to 2.9 for an explanation).

Because of this, the dividend yield on a share would have to be at least 11% higher than the interest rate paid by an investment, for the share to be a more attractive investment to a non-taxpayer.

For this reason, low income earners with savings should look to invest in financial instruments which generate interest rather than dividends. They should also elect to receive their interest without any deduction of tax at source (see 11.1 below).

TIP	Low income earners should look to earn interest rather than dividends on their savings.		
SAVE	£100's	**EASE OF USE**	Simple

10.14 Accrued income

When purchasing interest-bearing bonds and loan stock, part of the purchase price will probably include a proportion of the next payment of interest. This is known as **accrued income**.

If the value of **all** of your investments in bonds and loan stock is more than £5,000 **at any time** during the tax year in which the next payment of interest falls due, or the previous tax year, you can claim the amount of accrued income as a deduction in your Tax Return.

EXAMPLE

On 10 April 2005, Michael Beckham buys £6,800 nominal value of 5% Treasury Stock 2008 which pays interest on 7th March and 7th September. The contract note shows that accrued interest of £27 is included in the total price that he paid. During 2005/06, Michael receives interest payments of £170 on 7th September 2005 and 7th March 2006.

When Michael completes his Tax Return for the year ended 5 April 2006, he should declare interest income of £313 (being £340 of interest received less £27 of accrued income).

The documentation that you receive to confirm your purchase (the "contract note") will tell you how much accrued income is included in the price that you have paid.

TIP	Reduce interest income for any accrued income.		
SAVE	£100's	**EASE OF USE**	OK
What you need to do	Declare interest income received **less** accrued income in Box 10.12 of your Tax Return		

10.15 Married Couples

If you are married, you should consider transferring the ownership of investments into the name of the lower rate taxpayer. In this way, investment income will be taxed at the lower rate.

There are no other tax implications of the transfer itself, as transfers of assets between spouses do not attract Capital Gains Tax (see Section 19) or Inheritance Tax (see Section 20).

If the transfer is done between a higher rate taxpayer and a basic rate taxpayer, it will improve the after-tax returns on your investments by **30%.**

If the transfer is done between a higher rate taxpayer and a non-taxpayer, your after-tax returns will improve by **67%!!**

An example showing how this works is in 4.1.

We realise that some people might not feel comfortable giving up access to, and ownership of, their savings and investments. If you fit into this category, we suggest that you consider joint ownership – which will provide half of the tax benefits described earlier.

TIP	Reduce the tax that you pay on your savings and investment income by transferring assets to your spouse if he/she pays a lower rate of tax than yourself.		
SAVE	£100s	**EASE OF USE**	Simple

What You Need To Do	Estimate the total annual taxable income for each spouse By comparing these incomes with the tax bands, determine whether one spouse is paying tax at a higher rate than the other If one spouse is paying tax at a higher rate, estimate how much income this spouse is earning income from interest and dividends ("investment income") Calculate how much of this investment income needs to be transferred from the higher rate taxpayer to the lower rate taxpayer to "equalise" their tax rates (to make each taxpayer pay tax at the same rate) or, failing this, to at least bring the higher rate taxpayer down to a lower tax band Decide if the spouse is willing to transfer assets to the other spouse which generate this level of income Legally transfer the assets

10.16 Life assurance policies

What is life assurance? It is the simplest type of life insurance. You are covered for a specific amount (the "Sum Assured"), for as long as you want (the period of cover, or "Term").

Life Assurance policies may also pay out income as well as the Sum Assured (e.g. if you have a "with profits" policy). This income is not normally paid out during the lifetime of the insured person, but rather it is added to the money that is paid out on the death of the insured person.

Any proceeds from Life Assurance policies (either on maturity or on death) are **not** subject to **<u>income tax</u> if**;

- the policy is secured on the life of **you or your spouse**,
- premiums are payable every year **for ten years or more** (or for 3/4 of the Term, if this is shorter),
- the premiums are reasonably **even in amount** (i.e. of similar value) over the life of the policy.

Any policy that complies with these requirements is defined as being a "Qualifying" policy.

So, proceeds from Qualifying Life Assurance policies are exempt from income tax. However, any amounts paid out by such policies upon the death of the insured, will be subject to ***Inheritance Tax*** **<u>unless</u>** the policy is "written in trust" for a named beneficiary. In this case, the amount paid out by the Policy does not form part of the deceased's estate and is not subject to Inheritance Tax.

The technique of writing the benefits of an insurance policy "in trust" for someone is described in 20.6, later in this Guide.

TIP	If you take out a life assurance policy to provide for the financial security of your dependents upon your death, the proceeds will not be subject to income tax if the policy is a qualifying policy		
SAVE	£1,000's	**EASE OF USE**	OK
CONSIDER	You should write your life assurance policy "in trust" for the executor of your will, so that the proceeds are not subject to **<u>Inheritance Tax</u>** and he/she can use the proceeds of the policy to pay the Inheritance Tax that is due on the rest of your estate on your death (see Section 20 on Inheritance Tax).		

10.16.1 Withdrawals

We mentioned “Qualifying” policies in 10.16. Lets move on now to talk about **non-qualifying** life assurance policies.

The whole area of non-qualifying policies is a little complicated, so bear with us while we try to explain it step-by-step. It is worth knowing, as it is an area that has its own tax savings opportunities.

The first point to make is that you will pay income tax on any gains that you make on non-qualifying policies. A gain is calculated as being the proceeds on maturity of the policy plus any amounts withdrawn during the life of the policy, less any premiums that you have paid.

Note: A qualifying policy is also taxed in this way if it is cashed in less than 10 years after it was taken out (as this act makes the policy “non-qualifying”).

When it comes to calculating the income tax that is payable on such a gain;

- the gain is reduced by “top slicing relief” before it is taxed. This basically means that the gain is divided by the number of complete years that the policy has been in existence, to give a profit “slice”.

- This profit “slice” is then treated as the top layer of your income in that tax year and, to the extent that the profit falls within the higher rate band for income tax, it is taxed at 20% from 2004/05 onwards. If it falls wholly below the higher rate band, no tax is payable.

EXAMPLE

Barry Dare cashed in a life assurance policy in November 2005, 5 ½ years after it started. Barry received £65,000, having paid premiums totalling £50,000 and having withdrawn £10,000 over the life of the policy.

The gain on the encashment of the policy is £25,000, being £65,000 plus £10,000 less £50,000.

The profit slice on the policy is £5,000, being £25,000 divided by 5.

Barry Dare had taxable income (after reliefs and allowances but before cashing in his life assurance policy) of £29,750 in 2005/06.

The first £750 of the profit slice is not taxed, as the higher rate tax band starts at £30,500 for 2005/06. The remaining £4,250 of the profit slice is taxed as it falls within the higher rate income tax band.

Barry will therefore pay tax of £765 on the cashing in of his life assurance policy, being 18% of £4,250.

There are two important points to note about non-qualifying policies;

- Firstly, you can make “5% withdrawals” each year **without paying any income tax** (NB: *A “5% withdrawal” means that you can receive an amount equal to 5% of the premiums that you have paid),* and

- Secondly, any 5% withdrawal that is not made **can be carried forward and taken in future years**.

If a withdrawal exceeds 5%, the excess is subject to top-slicing relief in the same way as the gains described earlier, and this excess “slice” is then treated as the top layer of the recipient’s taxable income. To the extent that this slice falls within the higher rate income tax band, it is taxed at 20%. If this excess slice falls below the higher rate income tax band, it is not taxed.

All of this means that you have the flexibility to take a withdrawal from a life assurance policy in those years when your income is insufficient to reach the higher rate band (and not pay any tax on the withdrawal), and to defer any withdrawal in those years when your income is over the higher rate band.

This is a very useful method for augmenting your income without increasing your tax liability.

The death of the insured party under a non-qualifying policy will create an income tax charge, based on the difference between;

(i) the sum of the "cashing in value" of the policy on the date of death plus any withdrawals made during the life of the policy, and

(ii) the total value of the premiums paid.

It is **not** calculated by reference to the amount actually paid out on the death claim.

TIP	Taxpayers should consider using non-qualifying life assurance policies to receive tax-free income		
SAVE	£100's	**EASE OF USE**	Difficult
What you need to do	Speak to an IFA or, if you are knowledgeable, speak directly to the financial organisations that offer non-qualifying life insurance policies. You will need to shop around and compare the charges and investment performance of different companies' policies. You should also consider the financial strength and reputation of the companies concerned as you are effectively relying on them to provide the financial security for your dependents. If you have access to the internet, you might also browse through "independent" sites, such as www.moneysupermarket.co.uk", to see what policies, if any, they recommend.		

10.17 Other Tips of relevance elsewhere in this book

Taper relief – see 19.6 (and, specifically, the benefits of investing in "business " assets)

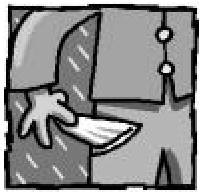
Invest for growth – see 19.21

****** HELPFUL HINTS ******

10 tax-efficient uses for a lump sum

		Refer to
1	Invest in an ISA – for you, your wife, your children…	10.1
2	Put money into your pension	Section 18
3	Reduce your mortgage	8.16
4	Put money into a trust for your children or grand-children	20.16
5	Buy National Savings & Investments products	10.3 to 10.6
6	Buy a purchased life annuity	6.6
7	Give to charity	12.2
8	Enter into a gift and loan back arrangement	20.12
9	Invest in "business assets"	19.6.3
10	Invest in Venture Capital Trusts or Enterprise Investment Schemes	10.9, 10.10

11 PEOPLE ON LOW INCOMES



You should read this Section if you are earning less than £8,500 a year.

In this Section you will learn;

- **How to receive interest income without paying tax**
- **How to receive salary without paying tax**
- **How to claim a tax refund**

11.1 Receive interest gross

If your taxable income is less than your personal allowances and you receive interest from a bank or building society, you should register to have your interest paid gross.

This means that the bank or building society will not deduct income tax (currently 20%) from the interest before it is paid to you.

Your should ask your bank or building society for the standard Inland Revenue Form R85, which you will need to complete and return to the bank or building society in order to receive interest gross.

You can register more than one account with the same bank or building society on one form, but you will need to complete a separate form for each different bank or building society that you receive interest from.

The form is simple to complete (requiring only the most basic of details about yourself – address, national insurance number and date of birth – and the account(s) itself – account number, bank/building society name and branch name).

TIP	Receive interest income without having any tax deducted at source		
SAVE	£100's	**EASE OF USE**	Simple
What you need to do	Ask your bank or building society for a Form R85. Complete the Form and return it to the bank or building society.		

11.2 Tax refunds

If you think that you might be due a repayment of income tax for a tax year, maybe because;

- you received interest income with tax deducted at source, but your total income for the tax year was less than the amount of your personal allowance; or
- you received salary or wages, but the wrong tax code was used to calculate your net earnings;

and you **do not fall** within the scope of Self Assessment (i.e. you do not complete a Tax Return), you should call your local Inland Revenue Enquiry Centre and ask them to send you a Repayment Claim Form (Form R40). You should complete this form and return it to your local Tax Office. You can find contact telephone numbers for your local Enquiry Centre and your local Tax Office by looking under “Inland Revenue” in your local phone book

The Inland Revenue will calculate your tax position for the year based on the information that you provide on the Form and send you any repayment of tax due to you.

There is **no time limit** for the Form to be submitted and claims can generally be made for the previous **six tax years**.

TIP	Receive a repayment of income tax		
SAVE	£100's	**EASE OF USE**	OK
What you need to do	Get a Form R40 from your local Tax Enquiry Centre Complete the Form and send it back to the Inland Revenue		

11.3 Receive salary gross

If you expect that your total income for the tax year will be less than your personal allowance, you should ask your employer for a Form P38(S).

Once you have completed and returned this form to your employer, you will receive your wages without deduction of any Income Tax.

TIP	Receive your salary without any deduction of tax		
SAVE	£100's	**EASE OF USE**	Simple
What you need to do	Get a Form P38(S) from your employer. Complete the Form and return it to your employer.		

11.4 Claim Tax Credits

Claim Working Tax Credit and Child Tax Credit.

TIP	Claim Children's Tax Credit and Working Tax Credit		
RECEIVE	£1,000's	**EASE OF USE**	OK
What you need to do	See 5.1 and 5.2 - the Tips on CTC and WTC. Refer also to the "Guide to Tax Credits", and in particular the Tax Credit checklist, which you received FREE with this Guide, which will tell you whether you are entitled to receive any Credits.		

11.5 Other relevant Tips elsewhere in this book

- Company car – see 7.12.2

12 PEOPLE WHO GIVE TO CHARITY

You should read this Section if you give to charity, or are considering giving to charity in the next 12 months.

In this Section you will learn;

- **How you can give to Charity and save tax**
- **How you can give to Charity and claim a tax refund**
- **Why you should give assets to Charity, rather than sell the assets yourself and donate the proceeds**

12.1 Introduction

The Government will give 22p for every 78p that you give to charity, **<u>if</u>** you donate using Gift Aid or a Deed of Covenant arrangement that was in place on 6th April 2000. These methods are described below.

It has been estimated that, if we ***all*** gave to charity in these ways, the Government would give nearly **£400 million** more to charity each year.

12.2 Gift Aid

The Gift Aid scheme replaced the old "deeds of covenant" arrangements on 6th April 2000, although deeds of covenants that were in existence at that date will continue to run until the end of their term.

Under Gift Aid there is **no minimum donation** that you have to make and all gift aid payments qualify for basic rate tax relief (which means that the charity will be able to claim back 22p for every 78p that you give).

In addition, if you are a higher rate taxpayer, you can claim back a further 18% tax relief (the difference between the tax that they have paid – at 40% - and the tax reclaimed by the charity - of 22%) on your Tax Return or directly through your Tax Office. This will reduce your tax bill for the tax year in which you made the gift.

Before we go on, lets just clarify how the tax relief is calculated based on the amount that you donate:

- **In order to calculate how much tax the charity will be able to reclaim**, you need to divide your donation by 78 and multiply the answer by 22.
- **In order to calculate the gross donation** (i.e. the total amount that will be received by the charity *including* the amount of tax that they can reclaim), you need to divide your donation by 78 and multiply the answer by 100.
- **In order to calculate how much tax relief <u>you</u> will get** on your donation **if you are a higher rate taxpayer**, you need to divide your donation by 78 and multiply the answer by 18. The amount of tax relief that you will get is 18% of the gross donation or 23.08% of the amount that you actually pay to the charity.

ILLUSTRATION

If you give £200 to Children In Need;
- *The charity will be able to reclaim £200/78 x 22 = £56.41*
- *The gross donation will be £200/78 x 100 = £256.41*
- *If you are a higher rate taxpayer, you will be able to claim tax relief of £200/78 x 18 = £46.15*

TIP	Give to charity using Gift Aid **unless** you are a non-taxpayer.
What you need to do	In order to make a payment under Gift Aid, you should ask your chosen charity to send you a Gift Aid form, which you need to complete and return to them.

TIP	Higher rate taxpayers can claim 18% tax relief on Gift Aid payments to charity		
SAVE	£100's	**EASE OF USE**	OK
What you need to do	Include gift aid payments in box 15A.1 of your Tax Return		

12.2.1 Carry back relief

If you are a higher rate taxpayer **and** you make a gift to charity using Gift Aid, you can elect to have your **higher rate tax relief** (i.e. 18% of the value of the gross donation) "carried back" to the previous tax year.

The election can be made for any or all Gift Aid payments made between the end of the tax year and the date when you submit your Tax Return (or 31st January if earlier).

This is particularly useful if your earnings fluctuate from one year to another and you have earned sufficient income in the *previous* tax year to pay tax at the higher rate but there is no guarantee that you will earn sufficient income in the *current* year to pay tax at the higher rate. By carrying the higher rate tax relief back to the previous year, you ***guarantee*** that you will benefit from it – it will either reduce the remaining tax that you have to pay for the previous tax year or, if you have already paid your tax bill for the previous year, it will generate an immediate tax refund.

If you are a higher rate taxpayer in both years, carry back relief won't save you tax, but it will reduce your tax bill for 12 months.

EXAMPLE

George Paish, a higher rate taxpayer, makes a Gift Aid donation if £1,500 on 1 June 2005.

The basic tax reclaimed by the charity is £423.08, being £1,500 x 22/78.

The gross amount received by the charity is therefore £1,923.08.

George can reclaim higher rate relief of £346.15, being £1,923.08 x 18%.

George can choose either to;

- Carry back the tax relief of £346.15 and reduce his tax bill in respect of the previous tax year (2004/05); or
- Claim relief for the payment in the current tax year (2005/06).

Given that he is a higher rate taxpayer in 2004/05, he should elect to carry back the relief to that year.

TIP	Carry back higher tax relief on charitable donations to the previous tax year		
SAVE	£100's	**EASE OF USE**	OK
What you need to do	Fill in box 15A.4 on your Tax Return		

12.2.2 Low income earners

If you are a non-taxpayer, or a 10% taxpayer, you should **not** make payments to charity under Gift Aid.

This is because the Inland Revenue is entitled to claim back from you any difference between the basic rate tax reclaimed by the charity and the total tax paid by you in the tax year.

EXAMPLE

Jack Bruce, 74, pays tax at 10%. His tax liability for 2004/05 was £50.

During 2004/05, Jack made a Gift Aid donation to Oxfam of £500. The tax reclaimed by Oxfam on this donation is £141.03 (being £500 x 78/22).

As Jack will only pay £50 of tax for the tax year, the Revenue can reclaim £ 93.03 from him.

TIP	Don't use Gift Aid to make payments to charity if you do not pay tax, or if you pay tax at the starting rate.		
SAVE	£10's	**EASE OF USE**	Simple

12.3 Payroll Giving

Payroll Giving is a simple, tax effective, way of giving to Charity;

- You allow your employer to deduct regular charitable contributions from your pay,
- Your employer then pays these donations to a Payroll Giving agency approved by the Inland Revenue,
- The agency distributes the money to the charity of your choice.

The contributions are deducted from your gross pay (i.e. **before your tax is calculated**), which means that you immediately get tax relief **at your top rate of tax**.

The amount that you donate is treated as the gross donation.

ILLUSTRATION

If you pledge £10 a month to charity through Payroll Giving, your net pay will reduce by £7.80 if you are a basic rate taxpayer and £6.00 if you are a higher rate taxpayer.

You can change the charities that you give to at any time by telling the Payroll Giving agency.

As far as tax is concerned, Payroll Giving results in **you** getting the basic rate **and** higher rate tax relief, whereas under Gift Aid, **the charity** effectively gets the basic rate relief and **you** get the higher tax relief. This is best illustrated by way of example.

EXAMPLE

Terry Cook is a higher rate taxpayer and in 2005/06 he donated £300 to Cancer Research through a one-off Gift Aid payment and £25 a month to the NSPCC through Payroll Giving. Over the course of the tax year, he donated £300 to both charities.

Terry's tax bill for 2005/06 will reduce by £69.23 because of the donation that he made to Cancer Research through Gift Aid (being 18% of £384.61), and Cancer Research will reclaim £84.61 from the Government. Cancer Research will therefore receive £384.61.

Terry's tax bill for 2005/06 will reduce by £120 because of the donations made to the NSPCC through Payroll Giving (being 40% of £300). The NSPCC will receive £300.

In summary, the Gift Aid donation of £384.61 cost Terry £230.67, whereas the Payroll Giving donation of £300 cost Terry £180.

Note: If you give to charity using a Payroll Giving scheme, the amount of pay showing on your Form P60 or P45 is the amount **after deducting** your charitable donations. As such, you do not need to report these donations separately on your Tax Return, as you do with Gift Aid payments.

TIP	Give to charity using Payroll Giving		
SAVE	£100's	**EASE OF USE**	Simple
CONSIDER	There is no carry back relief for any higher rate tax in respect of amounts given to charity under a Payroll Giving scheme. **<u>You</u>** will get more tax relief by making charitable donations under a Payroll Giving scheme than by making payments using Gift Aid.		
What you need to do	Tell your employer that you would like to make donations to charity using the Payroll Giving scheme and fill in the necessary forms.		

12.4 Maximise your tax benefit from donating to charity

If you are married, and either you or your spouse is a higher rate taxpayer, it makes sense for the **higher rate taxpayer** to make the charitable donations.

A higher rate taxpayer will be able to claim tax relief for 18% of the gross value of the donation, whereas a basic rate taxpayer will not be able to claim any tax relief.

EXAMPLE

Gary Ferdinand has taxable income of £15,500 in 2005/06. His wife, Chardonnay, has taxable income of £37,500.

The Ferdinand's decide to make a Gift Aid payment of £1,000 to Children in Need. The gross donation will be £1,282.05 (being £1,000 x 100/78).

If Gary makes the donation, the charity will receive £1,282.05, but the Ferdinand's combined tax bill will be the same.

If Chardonnay makes the donation, the charity will still receive £1,282.05, but the Ferdinand's tax bill will reduce by £230.77 (being £1,282.05 x 18%).

TIP	If you are married, get the higher rate taxpayer to make any charitable donations		
SAVE	£100's	**EASE OF USE**	Simple

12.5 Donating assets

If you are considering selling assets so that you can donate the proceeds to charity, think again.

Any gain that you make on the sale of your assets will be taxable and, if your annual gains exceed your annual Capital Gains allowance, you will be liable to pay Capital Gains Tax. (Refer to Section 19 for more discussion on Capital Gains tax).

It would be far better for you to donate the assets themselves, as the charity will be able to sell the assets tax-free.

EXAMPLE

Steven Lampard, a higher rate taxpayer, has decided that he wants to make a donation to charity.

Steven owns a valuable painting that he was left by his grandmother 3 years ago but that he has never liked. The painting has been valued at £15,000.

If Steven sold the painting in 2005/06, he would pay capital gains tax of £2,600, leaving £12,400 to give to the charity of his choice.

If Steven gave the painting to charity, the charity would be able to sell the painting and receive the entire proceeds of £15,000 ***without paying any tax.***

TIP	Donate assets to charity, rather than selling them and donating the proceeds		
GIVE	£1,000's	**EASE OF USE**	Simple

12.6 Make donations before the end of a tax year

If you are a higher rate taxpayer, you should make donations at the end of one tax year, rather than at the beginning of the next tax year.

EXAMPLE

It is April 2006 and Ashley Campbell, a higher rate taxpayer, wants to make a one-off gift of £1,000 to Childline.

If Ashley makes the gift on 5th April 2006, it will fall into the 2005/06 tax year, and it will therefore reduce the tax that he will have to pay on 31st January 2006 (by £230.77).

If Ashley makes the gift on 6th April 2006, it will fall into the 2006/07 tax year, and it will therefore not reduce the tax that he will have to pay until 31st January 2007.

The reduction in his tax bill is the same (£230.77), but by bringing the donation forward by a day, Ashley is effectively better off for 12 months.

TIP	Make donation in an earlier tax year and be better off for 12 months		
BENEFIT	£100's	**EASE OF USE**	Simple

12.7. Make donations while you are alive!

If you leave money to charity in your will, the gift is free of Inheritance Tax. However, if you make the gift while you are alive (using Gift Aid), not only do you save the IHT, but you also get Income Tax relief.

If you want to, you can agree with Revenue and Customs to gift the income tax that you have saved to charity. Gifts while you are alive are much more tax-efficient than waiting until you die.

TIP	Make charitable donations while you are alive		
BENEFIT	£100's	**EASE OF USE**	Simple

13 STUDENTS

You should read this Section if you have a Student Loan, or if you are currently in Further Education

In this Section, you will learn;

- **How to save for your future education and not pay any tax on the income and gains that you earn**
- **When and how you can reclaim student loan repayments**

13.1 Individual Savings Accounts

If you have savings, you should consider putting them into a Mini Cash ISA. If you do not know about ISAs, or how they work, you should refer to 10.1 now.

All of the interest that you receive from a Mini Cash ISA will be **tax-free.**

This will leave all of your personal allowance available to cover any other taxable income that you earn in the year (e.g. income from holiday jobs).

TIP	Put your savings into a Mini Cash ISA so that you receive interest tax-free		
SAVE	£100's	**EASE OF USE**	OK
What you need to do	Shop around. Decide which Mini ISA you want to invest in, based on the interest rate and the ISA charges. If you are not sure, speak to an IFA Decide how much you want to invest Open an ISA, by approaching an ISA Manager yourself, or by getting an IFA to do it. You will need to fill in a few forms to get the ISA started and **always** make sure that you understand what fees and charges you are paying before you sign the forms.		

13.2 Student loans

Repayments of student loans are collected by the Inland Revenue when you get a job, along with any income tax due on your income.

The Student Loans Company will inform the Inland Revenue when you leave university. If you get a job, your employer will be required to deduct the repayment along with PAYE. If you become self-employed, the repayment is collected through the Self Assessment system.

The current rules state that you must repay your student loan at the rate of 9% of your annual income over £10,000. However, when calculating what your "annual income" is, all taxable benefits are ignored, as is any investment income of less than £2,000 a year.

The repayments normally start at the beginning of the tax year after you have finished your course.

ILLUSTRATION

If you finish university in June 2005, your student loan repayments will begin in April 2006.

You will start to make repayments once you are earning **at a rate of** more than £10,000 a year.

ILLUSTRATION *If you start a job earning £20,000 a year, your student loan repayment will be deducted from your first monthly salary (and **not** after you have earned £10,000 after working for 6 months).*

If you do not keep your job, or your income reduces, you may be entitled to a refund of loan repayments.

EXAMPLE *Michael Rooney leaves university in June 2005. He starts work in October 2005 for a pharmaceutical company as a human guinea pig, earning £22,000 a year. He is fired on 1st September 2006 for "poor timekeeping".* *Michael will have made student loan repayments in 2006/07 of £90 a month for April, May, June, July and August. The repayment of £90 is calculated as follows;* *Take the excess of Michael's annual income (£22,000) over £10,000 = £12,000* *Multiply this by 9% = £1,080* *Divide this by 12 to get the monthly repayment = £1,080/12 = £90/month.* *If Michael did not get another job in 2006/07, he would be entitled to a refund of these repayments as he will only have earned £9,167 in 2006/07 (being 5 months at £1,833 a month).*

TIP	Claim a refund for loan repayments if you do not earn more than £10,000 in a tax year		
BENEFIT	£100's	**EASE OF USE**	OK
What you need to do	Call the Student Loan Company repayment helpline on 0141 204 5605		

TIP	If you want to minimise your student loan repayments, you should take fringe benefits rather than salary, as fringe benefits are not included in the calculation of your "income".

13.3 Get educated – in a tax sense

For full details of your Tax position while studying, get a copy of the Inland Revenue Leaflet IR60 "Income tax and students", which is available from your local Tax Office.

TIP	Read IR60.
What you need to do	Call the Inland Revenue on 0845 9000 444 and ask them to send you a copy

13.4 Other relevant Tips elsewhere in this book

- Buying accommodation for a child - see 5.5
- Receive interest income gross – see 11.1
- Receive salary gross – see 11.3

14 DIRECTORS

You should read this Section if you are a Director of a company.

In this Section, you will learn;

- **How to receive money from your company without paying any tax**
- **Why you should check your National Insurance deductions when you change jobs**
- **Why you may still have to pay tax even if you haven't paid yourself a salary**
- **When you will pay tax if you have been given a loan from your company**
- **Why it is better to take a bonus in the form of assets rather than cash**

14.1 National Insurance

The National Insurance system works differently for directors than it does for employees.

National Insurance Contributions (NICs) for directors are calculated on a "year to date" basis, rather than being spread evenly over the tax year. As a result, a director will earn £4,895 in 2005/06 (£5,035 in 2006/07) **before** either the director or the company are due to pay any NI.

If you are a director, you leave an employment during a tax year, and your NICs have been calculated as if you were an employee, you will have overpaid NICs and you will be due to receive a rebate.

There are 6 steps that you will need to take in order to check that the right amount of NI has been deducted from your salary;

Step 1	Find out whether you are contracted out of the State Second Pension (formerly the State Earnings Related Pension scheme ("SERPS")) or not
Step 2	Work out the gross pay that you earned in the tax year before you left employment
Step 3	Deduct £5,035 from your gross pay to arrive at your taxable pay (deduct £4,895 if you are trying to check the NI that you have paid in 2005/06)
Step 4	Multiply the first £28,505 (£27,865 for 2005/06) of your taxable pay (or, if less, the whole of your taxable pay) by 11% (or by 9.4% if you are contracted out of the State Second Pension)
Step 5	Multiply any excess of your taxable pay over £28,505 (£27,865 for 2005/06) by 1%
Step 6	Add up the results of Step 4 and Step 5 – this is the amount of NICs that you should have paid

TIP	If you are a director of a company and you move jobs during the tax year, check that you have paid the right amount of National Insurance.
What you need to do	Follow the 6 steps outlined above to calculate how much NI you should have paid Compare this amount with your Form P45 If the amounts differ, contact the National Insurance Contributions Office (NICO) and ask for a NI refund.

14.2 Benefits in kind

Directors have to pay tax on Benefits in Kind no matter how high or low their earnings (the £8,500 earnings limit explained in 7.7.1 does not apply to directors).

What you need to do	If your tax code has not been adjusted to take account of the taxable benefits that you are receiving from your employer (see 7.1 for an explanation of how to check your tax code), make sure that you put money aside to cover the tax that you will have to pay on these benefits when you submit your Tax Return

14.3 Start up costs

It is quite common for people who are involved in the start up of a business, to lend cash and/or sell equipment to the business.

The amount of money that is lent, along with the value of the equipment that is sold[17], should be treated as a loan from the individual to the business and recorded as such in the business's accounting records.

The advantage of this is that a current (or loan) account can be ***repaid*** to the individual (be they director, shareholder or employee) without any tax being paid either by the individual or by the company.

If you are owed money by a business, it therefore makes tax sense for you to take money out of the business as follows;

- firstly in the form of a repayment of the current (or loan) accounts, and
- secondly (and only after any current or loan account has been fully repaid) in the form of dividends or salary.

Important Note: Money that an individual has paid to acquire shares in a business, either to the company itself in return for the allocation of new shares, or to an existing shareholder for their shares, cannot be treated in the same way as this, as the money is not ***repayable*** *to the individual by the company. As such, it cannot form part of a loan account between the company and the individual.*

TIP	Get your loan and current accounts repaid before you take salary and dividends.		
SAVE	£1,000's	**EASE OF USE**	Simple

14.4 Company Loans

If you are a Director of a company and you owe money to that company, you need to ensure that your "loan" is repaid within 9 months of the date of the company's accounting year-end (the date up to which accounts are prepared).

[17] The money that is owed to an individual for assets (e.g. plant, machinery, equipment and computers) that he or she has sold to a business should be based on the commercial market value of the asset(s) on the date of sale.

If repayment is not made, and the balance of the loan is more than £5,000, you will be treated as receiving a **taxable benefit**.

The taxable benefit is calculated as the difference between the interest that you paid on the loan in the accounting period and the interest that you would have paid using the Inland Revenue's official interest rate (currently 5%).

As interest rates are relatively low at the moment, the tax that you will have to pay is not huge – an interest-free loan of £10,000 would cause you to pay £200 of tax if you are a higher rate taxpayer and £110 if you are a basic rate taxpayer.

In addition to the taxable benefit on the director, **the company** may also be required to pay tax. If;

- the company is a 'close' company (which is, broadly, a company controlled by its directors or by five or fewer shareholders), and
- the company is owed money by a director, and
- the money is not repaid within nine months of the end of the accounting period, then

the company is required to make a tax payment to the Revenue equal to 25% of the amount that it is owed by its director. The tax is not repaid to the company until nine months after the end of the accounting period in which the director repays the loan to the company.

TIP	Avoid a taxable benefit by reducing the total amount that you have borrowed from your company to less than £5,000 by the date of the company's year-end. To avoid an extra tax charge on your company, you should also ensure that the entire loan is repaid within 9 months of this date.		
SAVE	£100's	**EASE OF USE**	Simple

14.5 Your salary

If you are a director, your salary is **regarded as paid to you** when it is credited to a current account or loan account in your name in the company's accounting records.

The fact that it is not drawn in cash does not prevent the appropriate tax and national insurance being payable by the company at the time that your salary is credited to the account.

If your company does not pay the tax and national insurance, you, as a director, may be **personally liable** for the tax.

TIP	From your own perspective, if you are not taking salary out of the company, you should make sure that the company is still paying the appropriate PAYE and National Insurance contributions. From the business's perspective, if you are not taking salary out of the company, the company will save PAYE and NI if your salary is not credited to your current or loan account.		
SAVE	£1,000's	**EASE OF USE**	OK

14.6 Expenses

If the Inland Revenue discovers that a director's private expenses have been paid by a company and not declared on the director's Form P11D, they will treat the payments as loans to the director.

The section on "Company Loans" above (see 14.4) describes the tax implications of this for directors.

TIP	Check your P11D to make sure that all of your taxable benefits are declared		
SAVE	£100's	**EASE OF USE**	OK

14.7 Bonuses

14.7.1 Timing

The date on which a bonus is paid will determine **when** you will have to pay tax and (if income tax rates are changing) it may also affect **the rate** at which tax is payable.

ILLUSTRATION

A bonus paid to you on 15th March 2006 falls into the 2005/06 tax year, and you will pay tax on this bonus by 31st January 2007 based on 2005/06 tax rates.

A bonus paid on 15th April 2006 falls into the 2006/07 tax year, and you will pay tax by 31st January 2007 based on 2006/07 tax rates.

As income tax rates are the same in 2005/06 and 2006/07, you **will <u>not</u> save tax** by delaying the payment of a bonus or dividends at this time, however you **<u>will</u> delay the payment of any tax that is due**.

TIP	Where possible, defer the receipt of bonus payments to delay your tax bill and take advantage of changes in income tax rates.		
SAVE	£1,000's	**EASE OF USE**	Simple
CONSIDER	You may pay less tax by paying yourself a dividend rather than a bonus. See 7.27.		

You should note that a company can claim a tax deduction in its Corporation Tax return for employee/directors bonuses that are not paid at the end of the accounting period, **as long as** the bonuses are provided for (or "accrued") in the company's accounts **and** they are paid within nine months of the end of the company's accounting period.

Those of you that run your own companies therefore have the opportunity to reduce your company's corporation tax bill in one year by claiming a tax deduction in your company's Tax Return for a bonus payable to yourself, which *you* will not pay tax on until it is paid to you in the following tax year. In theory, this would seem to be a sensible step to take.

However, there are other two points that you need to consider;

(i) whilst this will defer your tax bill and therefore provide you with a cash flow benefit, it **will not reduce your overall tax bill**.; and

(ii) you may pay ***more*** tax if you pay yourself a bonus rather than a dividend than if you paid yourself a *dividend* (instead of a *bonus*). See 7.27 for a discussion of what is best – salary (i.e. bonus) or dividend?

WARNING	Before deciding on the payment of a bonus, you should see whether you would pay less tax by receiving a dividend.

14.7.2 Non-cash bonuses

Directors should consider whether to take bonuses by way of assets rather cash – e.g. by taking full ownership of a company asset, such as a computer, or a company car.

The benefit of this is that there is a much longer gap between the receipt of the asset and the payment of tax than there is with a cash bonus.

The tax on a cash bonus is **collected through the normal PAYE system**, which means that the director only receives the net bonus and the company pays the tax and national insurance directly to the Inland Revenue.

Transfers of assets, by contrast, are reported to the Inland Revenue on your Form P11D (with all other benefits in kind). As a result, the tax will be **due by 31st January following the tax year**. This means that the tax on an asset bonus taken at the beginning of a tax year won't be payable for well over eighteen months.

TIP	Take a bonus by way of asset transfer rather than cash and save tax for 18 months.		
SAVE	£1,000's	**EASE OF USE**	Simple

15 PEOPLE WHO COMPLETE TAX RETURNS

You should read this Section if you have to complete a Tax Return.

In this Section you will learn;

- **If you have to complete a Tax Return**
- **When you have to submit your Tax Return**
- **Valuable tips for completing your Return correctly**
- **The most common errors made in Tax Returns**
- **What penalties are charged for late submission of a Return, and how you can avoid them**
- **How to file your Tax Return via the internet**
- **What to do when faced with an Inland Revenue investigation**

15.1 Your Duty

Nearly ten million people will have to complete a Tax Return this year.

Even if you have not been sent a Tax Return, if you receive untaxed income in a tax year you have a **statutory duty** to;

(i) inform the Revenue by 6th October following the end of the tax year of the **untaxed income** that you have received, no matter how small it might be, and

(ii) complete a Tax Return.

ILLUSTRATION

If you received untaxed income in the 2005/06 tax year, you would need to inform the Revenue of this by 6th October 2006 and send off a completed Tax Return by 31st January 2007.

If you do not inform the Revenue of your untaxed income, you will be liable to pay hefty penalties and interest.

If you haven't been sent a Tax Return, and you have no untaxed income to declare, you do not need to submit a Return and you are not directly affected by Self Assessment.

TIP	If you have received income that you have not paid tax on, you will need to submit a Tax Return, even if you have not been sent one.		
SAVE	£100's	**EASE OF USE**	Simple
What you need to do	Call your Tax Office (if you have one) or your local Inland Revenue Enquiry Centre (you will find them under "Inland Revenue" in the business section of your phone book) and ask them to send you a Tax Return. If don't know whether you need to complete a Tax Return or not, speak to the Revenue and find out.		

15.2 Plan

Before you start….

- Make sure you have all the **pages of the Return** that you need.

  The various Supplementary pages are listed on page two of the Return and cover areas such as employment, rental income, share options and income from overseas (see 2.3 for a complete list). If you have not been sent all of the pages that you need, you can request them from the Inland Revenue's order line on 0845 900 0404 or downloaded from its website.

- Get all of the necessary **documents** together - it will save you time and hassle. These include your P60, P11D, your bank and building society interest statements and any dividend statements.

- Decide if you are going to send your Tax Return over the **Internet** - it's fast, easy, secure and your tax is automatically calculated for you. If you are comfortable working with computers, you should try this option (this is discussed in more detail in 15.26).

TIP	Plan ahead
What you need to do	Be organised and set 30 minutes aside soon after you have received your Tax Return to make sure you have all of the necessary supplementary pages and to pull together all of the documents you will need to fill in the Return.

15.3 Don’t do a Return

The Inland Revenue is keen to remove people from the Self Assessment system if they no longer fall within the various categories. If your tax affairs have recently become more straightforward, you may not need to complete a Tax Return.

Check through Section 2 of this guide (particularly 2.3) and see whether you need to fill in a Return.

If you are in any doubt, you should write to your Tax Office advising them of your situation and of any changes in your circumstances. They will subsequently let you know whether you need to complete a Return for the current tax year.

TIP	Don’t do a Return if you don’t need to

15.4 Rounding figures

When completing your Tax Return, the Revenue generously allows you to;

- round down income figures to the nearest pound (so that, for example, £41.79 becomes £41);

- round expenses up to the nearest pound (so that, for example, £41.29 becomes £42).

- round up tax credits and tax deductions. If there are a number of tax credits (e.g. from a number of dividends) you should calculate the total and then round it up – you should **not** round up each individual amount and then calculate the total.

If everything works in your favour, this might save you a fiver each year!

TIP	Round income figures down and cost figures up		
SAVE	£’s	**EASE OF USE**	Simple

15.5 Joint incomes

If you have a joint source of income (which typically is interest on a joint bank or building society account), you should enter only half the income on your Return. Your partner (or whoever) should include the other half on their Return.

In this way, you will not both pay tax on the full amount of interest.

TIP	Only enter **your share** of joint income on your Tax Return		
SAVE	£100's	**EASE OF USE**	Simple

15.6 Make full disclosure

Do not leave items off the Return, even if you do not know where they should be entered.

If you receive income and you cannot find where it should be entered in the Return, enter it under question 13 and then provide further details under the additional information box on page 8 of the Return. Omitting information from the Return is an offence, and "I did not know where to put it" is not a defence! The Revenue may fine you for such an omission.

TIP	Include all income on your Return		
SAVE	£100's	**EASE OF USE**	Simple
What you need to do	Use Question 13 to disclose income that you have received but which you have not included anywhere else in your Return		

15.7 Estimates

Do not <u>exclude</u> information from your Return just because you do not have **accurate figures**, as you can be **fined** for this omission.

If you do not have accurate figures;

- tick box 23.2 on page 9 of the Return to show that some of the figures are estimated; and
- state in the additional information box (23.9) when you expect to be able to provide the correct figures.

You are then required to advise the Inland Revenue of the correct amounts as soon as they are available.

You have a year from 31st January after the end of the tax year in which to provide confirmed figures.

ILLUSTRATION

You have until 31st January 2007 to provide the Revenue with accurate figures in respect of any figures that you have estimated in your 2004/05 Return.

TIP	Include estimates if you do not have ***accurate*** figures		
SAVE	£100's	**EASE OF USE**	OK
What you need to do	Use boxes 23.2 and 23.9 to explain what estimates figures have been included in your Return, and why. Make sure you inform the Revenue as soon as accurate figures are available.		

15.8 Receive a tax refund

Tick the box in Question 19 of your Tax Return. By doing so, you will receive a refund of any tax due to you.

If you do not answer "yes" to this question, it is likely that the Revenue will keep the amount and offset it against any tax that you owe in the future.

TIP	Tick the box in Question 19

You are allowed to go back up to six years to make a claim for allowances or reliefs that you have not previously claimed.

So, if you find an allowance that you are entitled to when you are completing your Tax Return for 2005/06, that you have not claimed in previous years, you can go back as far as the 2000/01 tax year to claim a refund.

TIP	Claim a tax refund for previous years		
SAVE	£1,000's	**EASE OF USE**	Simple
What you need to do	Contact your local Tax Office or an Enquiry Centre and explain the situation to them. They will probably require you to write to them confirming the circumstances that have given rise to your claim for a tax refund.		

15.9 Get help

If you're having problems with your Return, don't get mad, get help. Believe it or not, the Inland Revenue is there to help you. You could try;

- the Inland Revenue helpline on 0845 900 0444, or
- its enquiry centres which are listed under "Inland Revenue" in the phone book, or
- its website (www.inlandrevenue.gov.uk), which is full of a lot of useful information.

If you complete a Tax Return, the Revenue's telephone staff should be able to access your personal tax records at any time if you provide them with your Unique Tax Reference (UTR) number (which is given on the front page of your Tax Return) or National Insurance number. Try to avoid calling on a Saturday, as this is when their computers tend to be updated.

I know it sounds a little bizarre, but it really does work (and it is much cheaper than calling your accountant or tax adviser!)

TIP	If you are having problems with your Return, get help from the Revenue		
SAVE	£100's	**EASE OF USE**	OK
What you need to do	Call 0845 900 0444 or your local Inland Revenue Enquiry Centre, or log on to the Inland Revenue web site.		

Make sure that you keep a handy note of;

- your **National Insurance number** – as it can be used to bring up your computer records;
- your **Unique Tax Reference**, or UTR, which is a 10-digit number that you will find on the front of your Tax Return.

By quoting these on the phone and in any written correspondence, you will get a much quicker response from the Revenue.

TIP:	Keep a note of your National Insurance number and UTR

15.10 Check your tax

If you are submitting your Return before 30th September, it is worth doing your own calculation of what you owe (or what the Inland Revenue owes you) and keeping it safely with the rest of your important tax papers.

You can then use your estimate to check the Revenue's calculation. They do get it wrong sometimes - particularly if they can't read your writing on your Return!!

TIP	Check your tax bill		
SAVE	£1,000's	**EASE OF USE**	OK
What you need to do	Use the information provided in Section 2 to calculate what tax you owe to the Revenue. If the Revenue calculates a different figure, review their calculations against yours to see where the differences are. Try to establish whether the difference arises from their mistake, or yours. If you are unsure about why the Revenue has come up with a different figure than yours, call your local Tax Office and ask them to explain the tax charge to you.		

15.11 Receive a rebate quickly

The Inland Revenue owes a tax rebate to 1 in 4 **taxpayers**, and the sooner that you submit your Return, the sooner that they will pay this rebate to you.

If you think that you may be due a tax refund for the last tax year, and you have access to the internet, you should consider completing a 'dummy' Tax Return by using the free downloadable software from the Inland Revenue website, which you can find at "www.inlandrevenue.gov.uk/sa/text/evr/evr.htm."

By completing this soon after the end of the tax year, you can find out whether you are entitled to a tax rebate.

If you ***are*** due a rebate, you should complete and submit your Return as soon as possible.

TIP	Claim your tax rebate as quickly as possible
What you need to do	Check whether you are due a tax rebate by filling in a dummy Tax Return on the Inland Revenue's website. If you are due a rebate, get your return in as quickly as possible.

15.12 Check your Tax Return

The Inland Revenue will reject your Tax Return if it is not completed correctly.

These are the most common reasons for rejection:

- You have put a tick on page 2, next to one of the questions 1 to 9, to indicate that there are additional pages to be attached to the Return, but **no additional pages** were included,

- Where you have had more than one employment during the tax year, you have not completed **separate employment sheets** for each employment,

- You have entered the **list price** of a company car instead of the **taxable benefit** (as shown on form P11D) in box 1.16 on page E1 of the employment pages,

- You have put the **net amount** of employee personal pension premiums on page 5 of the Return, instead of the **gross amount**,

- You have **not written clearly** and/or have written outside boxes,

- You have **not fully completed** the self-employment supplementary pages (most particularly those boxes from 3.74 onwards),

- You have written "**to be advised**" instead of actual figures. If figures are not known, you should estimate them and state when the actual figures will be known,

- You have **not completed** all the sections on **pages 3 to 10**. If there is nothing to be entered in a section you should indicate this by ticking the "no" box next to each question,

- You have put information on a **separate schedule** instead of including it on the Tax Return,

- You have **not completed question 19** on page 8 of the Return, even when a repayment of tax is due,

- You have **not signed and dated** the Return on page 10.

Once you have completed your Return, you should always take 5 to 10 minutes to check it.

This will save the significant delays and hassles that would happen if the Revenue subsequently rejects your Return.

TIP	Check your return before you send it in		
SAVE	£100's	**EASE OF USE**	Simple
What you need to do	Make sure you have filled in all relevant boxes Make sure you have answered questions correctly and legibly Make sure you have filled in the required Supplementary pages and that they are included with your Return		

15.13 Submit your Return on time

15.13.1 Avoid a penalty

In 2006, over 1 million people missed the deadline of 31st January for filing their 2004/05 Tax Returns and incurred a penalty of £100.

TIP	Avoid a needless fine by submitting your Return on time		
SAVE	£100	**EASE OF USE**	Child's Play

If you have left it late, and you are submitting your Return close to the final deadline of 31st January, you should be aware that, due to badly worded legislation, a Return will be classed as "on time" if it is with the Revenue on 1st February. You will **not** be fined if the Return is received on February 1st.

TIP	Don't despair if you have missed the 31st January deadline. Get your Return in the following day and you won't be fined.		
SAVE	£100	**EASE OF USE**	Simple

If you have left it really, really, late, you can work through the night on 1st February as well!!

The Revenue will treat a Return as "on time" if it is posted directly through a Tax Office letterbox before 7 am on 2nd February.

TIP	Don't despair if you haven't got your Return to the Revenue on February 1st. Work through the night and deliver it before 7am and you will still avoid a fine.

Note (1): The Chancellor announced in his 2006 Budget that the deadline for submission of Tax Returns will change in 2008 from 31st January to 30th September for those file a paper return and 30th November for those who file their return by internet. Be prepared!

Note (2): The Government currently has no plans to bring forward the due dates for tax payment when tax return submission deadlines are brought forward.

15.13.2 Avoid an extended "investigation" period

If your Tax Return **is** submitted late, the Inland Revenue are also allowed to extend the period that they have to enquire into your Tax Return from 31st January in the following tax year to 30th April.

ILLUSTRATION

Your Tax Return for the year ended 5th April 2006 is due for submission by 31st January 2007. If the Return is late, then the enquiry period will be extended from 31st January 2007 to 30th April 2007.

Do not make it easier for the Revenue to enquire into your Return. Submit it on time.

TIP	Submit your Return on time and reduce the chance that the Revenue will enquire into your Return		
SAVE	£100's	**EASE OF USE**	Child's Play

15.13.3 Your target submission date is 30th September

Our suggestion is that you aim to get your return submitted by 30th September, rather than leaving it until the following 31st January. Why?

Firstly, if your return is not in by 30th September, there is no guarantee that the Revenue will tell you what tax you need to pay by 31st January (which is the deadline for paying the tax that you owe).

If the Revenue does not tell you what to pay by 31st January, you will either have to wait until they do tell you, in which case you will end up **paying interest** and possibly a surcharge, **or** you will have to **estimate yourself** what you need to pay. Neither option is attractive.

Secondly, you **do not have to pay your tax any earlier** if you submit your return by 30 September – you still have until 31st January to settle up your tax bill.

Thirdly, the Revenue has stated that an early submission of the Return **does not** increase the chances of them making an enquiry into it.

Fourthly, you will **receive a tax rebate more quickly**, if you get your Return in earlier.

There really are **no benefits** in delaying its submission.

TIP	Get your Tax Return in by 30th September		
SAVE	£100's	**EASE OF USE**	Simple

CONSIDER	Plan ahead and be organised. For example; • Read through the return in the summer, • Work out what information you need to fill in your return and get it all together, • Complete the return in early September, • Check it, • Submit it in the last week of September.

15.14 Late submission

If you can provide a "reasonable excuse" for the late submission of a Return, and this excuse is accepted by the Revenue, you will not be fined.

The Revenue has accepted the following as a "reasonable excuse" in the past;

- not having received the Tax Return in the first place,

- serious illness or bereavement,

- losing all your financial records through fire flood or theft, and

- postal delays, as long as there is a provable reason for this in the Post Office, such as strike or fire in the sorting office.

TIP	If you have a reasonable excuse for not getting your Return in on time, tell the Revenue and you will not be fined		
SAVE	£100	**EASE OF USE**	Simple
What you need to do	Write to your Tax Office explaining why your Return is late (if possible, write ***before*** 31st January)		

15.15 Avoiding a fine

15.15.1 Your maximum fine

You cannot be fined **more** than **the amount** that you **owe in tax**.

If you are due a tax refund, you will not have to pay a fine, regardless of when you submit your Tax Return. If you owe £30, you can only be fined £30.

However, beware. Any fine charged on you by the Revenue will continue to be payable **until your Return has been submitted** and **interest will be added daily**. The Revenue is completely entitled to chase you for payment of these amounts, **until your Return has been submitted**.

If there is an unavoidable reason for your Return being late, it is often easier to pay the fine, even if you do not think that you will owe any tax. It will be refunded when your Return is eventually submitted.

TIP	If you **know** that you will not owe tax for a tax year, you can submit your Return after 31st January, as you will not have to pay any late submission penalty.
CONSIDER	The Revenue will continue to chase you for payment of the late submission penalty **until** your Return has been sent in and interest will be added daily.

15.15.2 Check any fine

In May 2004, the Revenue issued an apology to over 50,000 people who, due to a glitch in their computer programmes, had **incorrectly** been fined for submitting their Returns late.

Don't pay penalties without checking that they have been correctly issued.

TIP	Check that a penalty notice is correct before paying it		
SAVE	£100	**EASE OF USE**	Simple

15.16 Take a copy

Always, always, make a copy of your Return before sending it to the Revenue.

If the Inland Revenue raises a query about your Return, it will be easier to discuss the problem with them if you have a copy that you can look at. Also, it is not unheard of for a Return to go missing in the post.

A copy will not only save you the hassle of having to produce a new Return, but it will be important evidence if the Revenue subsequently fine you for submitting your Return late.

TIP	Take a copy of your Return before sending it in.

15.17 Keep your documents

Do not enclose or attach any supporting documents (Form P60, Form P11D, etc) to your Tax Return. The Revenue will not look at them and may lose them.

TIP	Keep your documents

15.18 Tax overpayments

If you find out that you have overpaid tax, you should carefully check the Revenue's calculation of interest due to you. The Revenue's computer program has been known to get it wrong!

TIP	Check the calculation of interest due to you as a result of overpaying tax		
SAVE	£100's	**EASE OF USE**	OK

15.19 Keep the Revenue informed

If there are any changes to your personal circumstances that may affect your tax code, phone your Tax Office as soon as you can and tell them what has changed.

This will ensure that your tax code is always accurate, and you will avoid a large tax bill at the end of the year, or, worse still, paying too much tax *during* the year.

TIP	Tell the Revenue of any changes in your circumstances that might affect your tax position		
SAVE	£100's	**EASE OF USE**	Simple
What you need to do	Call your Tax Office or an Inland Revenue Enquiry Centre and tell them what has changed. It will help if you can quote your NI number or UTR code.		

15.20 Correcting errors

If you find that you have made an error in your Return *after* you have sent it to the Revenue, you should inform the Revenue.

You can amend your Return at any time up to the end of 12 months after the normal filing date without penalty, e.g. by 31st January 2007 for a 2005/06 Tax Return. If you do not inform the Inland Revenue of your errors, you can be fined.

TIP	Tell the Revenue if you find an error in your Return after you have sent it in		
SAVE	£100's	**EASE OF USE**	Simple
What you need to do	Call your Tax Office or an Inland Revenue Enquiry Centre and tell them what was wrong in your Return. It will help if you can quote them your NI number or UTR code.		

15.21 Getting priority treatment

The Inland Revenue give certain matters priority, such as repayments. If you consider that you are entitled to a repayment, write 'repayment claim' at the top of your letter, and your letter is more likely to be dealt with quickly.

TIP	Receive tax repayments quickly		
BENEFIT	£100's	**EASE OF USE**	Simple
What you need to do	Write "repayment claim" on your letter		

15.22 Unreasonable delays

The Inland Revenue aims to reply to enquiries or letters within 28 days. If, for no good reason, they take more than six months beyond their 28-day target, their 'Code of Practice 1' says they will;

- **waive interest** on any tax you owe them,
- **pay interest to you** on anything that you are owed during the delay, and
- **pay any reasonable costs** you incurred because of the delay.

TIP	Get paid by the Revenue if they take too long dealing with your enquiry		
SAVE	£100's	**EASE OF USE**	Simple
What you need to do	Write to the Revenue setting out the costs that you have incurred as a result of the delay and any interest that you have been incorrectly charged and/or interest due to you because of the delay.		

15.23 Late and unexpected tax bills

If you receive a late and unexpected tax bill, the Revenue may waive the tax due under extra-statutory concession A19.

TIP	Get the Revenue to waive a late and unexpected tax bill		
SAVE	£1,000's	**EASE OF USE**	Simple
What you need to do	Ask your Tax Office whether extra-statutory concession A19 applies to you.		

15.24 Enquiries and Investigations

The Revenue has one year from the deadline for submitting a Return to start a formal "enquiry". This means that they have until 31st January 2007 to enquire into your 2004/05 Return. You may still be investigated after this one-year period **if** the Revenue suspects you of fraud or negligence, **or if** you have not supplied full and accurate information.

If you receive notice of an enquiry, don't worry - it does not necessarily mean that there is something wrong with your Return. Many are chosen at random.

We recommend that you **fully co-operate** with the Revenue if they investigate your tax affairs. We also recommend that you seek assistance from a tax advisor if you are not sure of your position.

If the investigation finds that you owe tax, you will have to pay this amount plus interest and a penalty. This penalty will be reduced if you have been co-operative.

TIP	Co-operate with any Revenue enquiries or investigations		
SAVE	£100's	**EASE OF USE**	Simple

15.25 Coming clean

If you have broken the rules, you can get advice from the Revenue on how best to sort out the situation by calling their confidential helpline on 0845 608 6000. Their advisors will **not** ask you for any personal details – they will just advise you on how you can best rectify the problem.

TIP	Call the Revenue and get confidential advice on a "no names" basis
What you need to do	Call 0845 608 6000

15.26 Electronic Filing

If you are comfortable with the internet, you should make use of the online facilities provided through the Inland Revenue website

It is quite simple to do.

Firstly, you need to log on to the Inland Revenue website and click on the "Self Assessment" part of the "Do It Online" area. If you want to go directly to the relevant page type the following link in to your web browser;

https://online.inlandrevenue.gov.uk

You will then need to click on the "register" link, and then click in the "individual" box and click "next"

Then click on the "self assessment online" box and click "next".

After a couple of clicks on "next" you will be taken through to a "Registration page" where you need to fill in your name, e-mail address and a password.

You are then asked to fill in your Unique Tax reference number UTR) and either your national insurance number or your postcode.

The next page asks you to accept the terms and conditions of using the Inland Revenue's online services. Make sure you read them before clicking "accept"!

You are then issued with a unique USER ID number and you are advised to keep this number and your password in a safe place.

The final step is for the Inland Revenue to provide you with a unique Activation PIN (Personal Identity Number) for each service you enrol for. You will receive this in a letter from the Government Gateway within seven days of your online registration, after which time you can start using the online services. You will need to enter this PIN number when prompted when you try to use the online services for the first time.

The Activation PIN is valid for 28 days from the date shown on the Activation PIN letter. If you do not use it within this period you will need to register again.

Once your online account with the Inland Revenue is active you can do the following things online;

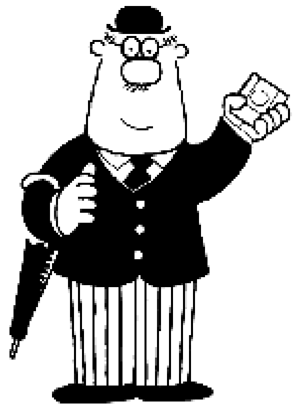
- View and change your personal details,
- File your Tax Return, view your account, check that the Revenue have received your Tax Return,
- Apply for Working Tax Credit & Child Tax Credit and let the Revenue know about changes in your circumstances,
- Apply for Child Benefit and let the Revenue know about changes in your circumstances, and
- Make tax payments

Registering to use these online services won't save you money (apart from the odd stamp, here and there), but it will save you a lot of time and it will make dealing with the Revenue much easier.

TIP	Use the online services provided by the Inland Revenue
What you need to do	Follow the step-by-step instructions provided above

16 PEOPLE MAKING TAX PAYMENTS

You should read this Section if you are submitting a Tax Return.



In this Section you will learn

- **About Payments on Account and how they are calculated**
- **When you should not make Payments on Account**
- **How to reduce your Payments on Account**
- **When to make your final tax payment to avoid an interest charge**

16.1 Payments on Account

If you are employed, you will receive your salary **after tax has been deducted**, and therefore you will pay most of your tax through the tax year via the PAYE system.

If you are self-employed, in contrast, you will **not pay tax on your income as it is received**.

In order to correct this inequality, the Revenue operates a "payment on account" system, which requires the self-employed to pay some tax during the year.

Under this system, if you are self-employed, you will be required to make two "**payments on account**";

- The first "payment on account" for a tax year is due to be paid by **31st January in that tax year**;
- The second payment on account is due to be paid by **31st July after the end of the tax year**.

The total of the payments on account will normally equal your **tax bill for the year before**, with half payable by 31st January and half payable by 31st July.

16.1.1 When you don't need to make payments on account

You **do not** have to make payments on account if;

- **80% or more** of your total tax liability for the year is **collected at source** (through PAYE, tax deductions on interest payments etc), or
- your total tax bill for the year is **less than £500**.

As the first payment on account is due at the end of January, before the tax year has ended, you will to need to ***estimate*** in January whether you are likely to comply with either of these exemptions for the tax year.

This will require you to think carefully about what your earnings and income are likely to be in the remaining 2 or 3 months of the tax year.

The best advice in this situation is, **if you are in any doubt** about whether either of these exemptions will apply to you, **pay on account**.

TIP	Do not make a payment on account if you **confidently expect** that either; • your tax bill for the year will be less than £500, or • more than 80% of the tax that you will owe for the tax year will be deducted at source.		
BENEFIT	£1,000's	**EASE OF USE**	OK
What you need to do	In January, you will need to estimate whether you are likely to comply with either of these exemptions. If you are in any doubt about whether you will comply, make a payment on account.		

16.1.2 How to reduce your payments on account

If you think that your tax bill will be **significantly reduced** from last year, you should apply to have your payments on account **reduced**.

The best way to do this is to complete the Inland Revenue form, **SA303**.

We would advise against writing a letter, or relying solely on filling in the relevant boxes on your Return, as these methods have proved unreliable in the past.

In order to complete the SA303 form, you will need to estimate what you think your tax bill is likely to be for the tax year. This estimate will then be used as the basis for your revised payments on account - the total of your new payments on account being equal to your new estimate, payable in two equal instalments.

If you think you will not owe ***any*** tax, you can reduce the amounts to zero and not pay anything.

But beware. If you underestimate the tax that you eventually have to pay, you will have to pay interest. The amount that you paid on account will be deducted from the higher of;

- your eventual tax bill, and
- the original payments on account advised by the Revenue,

and interest will be charged on this balance, running half from January and half from July.

TIP	Apply to have your payments on account reduced if your tax bill will be less than last year		
BENEFIT	£1,000's	**EASE OF USE**	OK
CONSIDER	Don't underestimate your tax bill, as you will pay end up paying interest		
What you need to do	Complete and submit a Form SA303.		

16.2 Final tax payment

You will be charged **interest** on late payment of tax if;

- your tax bill is more than the total of the payments on account made; **and**
- this additional tax is not paid by the 31st January after the end of the tax year.

This means that you have until 31st January following the end of the tax year to pay any difference between your actual tax bill for that year and the tax you have paid "on account".

As 31st January is also the deadline for the submission of your Tax Return, you should know what tax you have to pay at this time.

If you cannot get your Return in on time, but you know that your tax liability for a particular tax year will be more than the total of your payments on account, you should pay what you think you owe (or, better still, a little bit more than you think you owe) on or before 31st January.

If you pay at least the amount of tax that is eventually calculated as being due, you will not have to pay any interest.

TIP	Even if you can't get your Return in on time, you should still make a payment on 31 January following the end of the tax year of the tax that you think you owe.		
SAVE	£100's	**EASE OF USE**	OK

16.3 Interest

Interest is automatically charged from 1st February after the end of the tax year on any tax that is still unpaid.

If tax is not paid by 28th February, a surcharge of 5% will be added.

TIP	Pay your tax bill by the due date		
SAVE	£100's	**EASE OF USE**	Simple

17 PEOPLE WHO EARN OVERSEAS INCOME

You should read this Section if you earn income from overseas.

In this Section you will learn;

- **About "Domicile" and "Residence" and how they determine what tax you pay on your overseas income**
- **What you need to avoid paying tax in the UK if you work overseas**
- **How you can save tax by selling assets while you are overseas**
- **How to claim UK tax allowances if you are overseas**
- **Whether you need to submit a UK Tax Return when you are overseas**
- **How to minimise the tax that you pay if you have an overseas holiday home**

17.1 Introduction

There are 2 important concepts that determine the extent of your liability to UK tax on your overseas income;

- Domicile; and
- Residence

17.1.1 Domicile

Generally speaking, your domicile will be considered to be the country that is regarded as **your permanent home**.

It will normally be the country in which **your father was domiciled at the time of your birth** (**<u>not</u>** the country in which you were born) or, for women married before 1974, their husband's domicile.

Until the age of 16 your domicile will follow that of the person upon whom you are legally dependent. If the domicile of that person changes, you automatically acquire the same domicile (a "domicile of dependency").

You can change your domicile, but it is very difficult. You have to sever all links with your current country of domicile and provide a substantial amount of evidence to prove that you propose to live in your new country forever.

17.1.2. Residence

There are two categories – "residence" and "ordinary residence" – but neither is defined in law.

Each individual case is judged on its facts.

The following factors are taken into account in when judging the facts

- If you spend 183 or more full days in the UK in a tax year you will **always be regarded as resident in the UK**. You can ignore the days of arrival and departure for the purposes of calculating the period spent in the UK.

- If you spend less than 183 full days in the UK in a tax year, you will also be **treated as resident _if_** you visit the UK regularly and, **after 4 tax years**, your visits during those years average 91 days or more in a tax year.

- "Ordinary residence" is, simply, the country where you normally live. The Revenue would tend to look at a 3 or 4 year period to determine where the taxpayer **habitually resides**.

Note: The formula for working out the average number of days that you spend in the UK each year is as follows;

$$\frac{\text{Total visits to the UK (in days)}}{\text{Total period since leaving the UK (in days)}} \times 365 \text{ days} = \text{average days per year in UK}$$

EXAMPLE

Frank Scholes left the UK on 12 June 1999. Frank spent the following time in the UK in the next 4 tax years;

1999/00	*65 days*
2000/01	*54 days*
2001/02	*105 days*
2002/03	*85 days*

The average number of days that Frank spent in the UK over this period is calculated as follows;

$$\frac{65 + 54 + 105 + 85}{300 + 365 + 365 + 365} \times 365 = 80.8$$

As this is less than 91 days, Frank will be regarded as non-resident throughout the period.

So;

- You can be "resident" and not "ordinarily resident" in the UK if, for example, you are from overseas and you work in the UK.

- You can be "ordinarily resident", but not "resident" in the UK if, for example, you are from the UK and you are working overseas for a short time.

You can, incidentally, be resident in the UK and another country at the same time! Other countries "residency" criteria differ from those applied in the UK.

17.1.3 Taxation of income and capital gains

Having established what the key terms mean, let us now examine how they affect the tax that people pay **_in the UK_** on **foreign income and capital gains**.

Figure 17. How foreign income and capital gains are taxed in the UK

Status			Taxable in the UK	Taxable only if brought back to the UK[18]	Not taxable in the UK
RESIDENT	Ordinary resident	Domiciled	Foreign income and foreign capital gains		
		Not domiciled	Earnings from working abroad for a UK resident employer	All other foreign income and gains	
	Not ordinary resident	Domiciled	Foreign capital gains and foreign income except earnings	Foreign earnings as an employee	
		Not domiciled		Foreign income and capital gains	
NOT RESIDENT	Ordinary resident	Domiciled	Foreign capital gains		Foreign income
		Not domiciled		Foreign capital gains	Foreign income
	Not ordinary resident	Domiciled or not domiciled			Foreign income. Foreign capital gains unless only temporarily non-resident

As you can see from Figure 17, the most important distinction to make for tax purposes is whether you are "resident" or "not resident".

TIP	If you are living overseas, you will save UK tax on your foreign income and foreign capital gains if you are "not resident" for UK tax purposes.		
SAVE	£1,000's	**EASE OF USE**	OK
What you need to do	If you go overseas to live and work, make sure that you do not breach the 183-day and 91-day rules explained in 17.1.2 above.		

IMPORTANT TIP	**Don't think that you will save tax just by investing "offshore". You won't. Foreign income is fully taxable in the UK if you are UK resident and UK domiciled.**

17.2 Working Overseas

17.2.1 Working overseas full-time

If;

- you are working overseas **full-time**,
- **all** of your duties are to be performed overseas, and
- you will be overseas for a **complete tax year**,

[18] i.e. paid into a UK bank account

the Revenue will normally treat you as **non-resident** from your date of leaving the UK (although you will still be regarded as **ordinarily resident**). This is an important concession from the Revenue.

Note that it is **not** the **length of time** that you are overseas that is important, it is whether this period spans **an entire tax year**.

ILLUSTRATION

If you were away for 20 months from July 2004 to February 2006, you would remain resident in the UK throughout this period (as your period overseas does not span a complete tax year), whereas

If you were away for 15 months between March 2004 and June 2005, you would be regarded as non-resident for the entire period (as this includes the whole of the 2004/05 tax year).

If you take your spouse with you, he or she will be regarded as neither resident nor ordinarily resident even if he or she does not work overseas.

TIP	If you are working overseas, maximise your UK tax saving by timing the start and end of your work to maximise the number of complete tax years that you are overseas		
SAVE	£1,000's	**EASE OF USE**	OK

17.2.2 Leaving the UK permanently

If you can prove to the Inland Revenue that you are leaving the UK with the intention of living abroad for **at least three years** - or that you have already lived abroad permanently for that long – the Revenue will provisionally treat you as "**not resident**" **and** "**not ordinarily resident**".

This is very advantageous for tax purposes, as Figure 17 illustrates.

You will need to provide evidence of your intention to make a permanent home overseas and, provided that you do not infringe the 183-day and 91-day rules explained above, the Revenue will subsequently confirm your non-resident status.

As soon as you become "not ordinarily resident", you should apply to receive interest gross from UK banks and building societies.

TIP	Ask the Revenue to treat you as not resident and not ordinarily resident if you are going to live and work overseas for at least 3 years		
SAVE	£1,000's	**EASE OF USE**	OK
What you need to do	Submit a Form P85 to the Revenue before you go overseas. This will enable the Revenue to make a tax refund to you, if you are entitled to one, for the current tax year.		

17.2.3 Working overseas, but UK resident

As Figure 17 shows, if you work overseas, but you are classified as "resident" and "ordinarily resident" in the UK, all of your foreign income will be taxed in the UK.

However, you **may** be able to claim a **tax deduction** for certain costs that you incur. These costs fall into 4 categories;

1. Travel costs from your UK home to your place of work overseas at the start and end of the job,
2. Travel costs from your UK home to your place of work overseas during the job,
3. Costs of accommodation and living expenses whilst working overseas, and

4. Travel costs for your spouse and children from your UK home to your place of work overseas during the job.

In terms of tax deductions;

- You can claim a tax deduction for the costs described in 1 above **at all times**.

- You can only claim a tax deduction for the costs described in 2 and 3 above **if** the costs are paid for, or reimbursed by, your employer.

- You can only claim a tax deduction for the costs described in 4 above for **up to two return trips each year if** the costs are paid for, or reimbursed by, your employer **and** your job keeps you overseas for a continuous period of more than 60 days.

- As far as 2,3 and 4 are concerned, the tax deduction is given to offset the taxable benefit that you receive as a result of the costs being paid by your employer. The amount reimbursed by your employer will be listed on your Form P11D for the year.

To recap then, **no** tax deduction is given for costs of accommodation, living expenses and travel costs to and from the UK *during* an overseas job, **if** you pay these costs yourself **and** they are not reimbursed by your employer.

TIP	If you are UK resident, claim a deduction for certain travel costs and living expenses that you incur when working overseas.		
SAVE	£1,000's	**EASE OF USE**	OK

17.2.4 Self-employment overseas

If you are self-employed and non-resident, your business has to be controlled from overseas for your profits to be free of tax in the UK.

Irrespective of where your business is controlled from, any profits that you make from a branch or agency that is based in the UK, are taxed in the UK.

TIP	If you are self employed and you are not resident in the UK, you will not pay tax on your business's profits as long as it is not "controlled" from the UK and it does not have any UK operations.		
SAVE	£1,000's	**EASE OF USE**	OK
What you need to do	Don't have an office in the UK Don't hold business meetings in the UK		

17.2.5 Frequent overseas trips

The Revenue will treat you as **resident in the UK even if** you pass the 183-day and 91-day tests explained in 17.1.2 above **if**;

- You have no settled home abroad, **and**

- You have no intention of staying abroad indefinitely, **and**

- You return to a UK home and a UK working base at the end of each overseas job.

Don't assume that you will be classed as non-resident, just because you meet the 91-day and 183-day criteria – the Revenue will still look at the facts of the case before determining your tax status.

For the few of you that **constantly work overse**as, it is worth considering "basing yourself" in a tax-friendly overseas location – such as Andorra or Liechtenstein - and by that we mean have a home in this country, which you return to at the end of each job.

There will be non-financial disadvantages of basing yourself overseas, such as being unable to see your family and friends regularly and the loss of your "home comforts" in the UK. You will need to weigh up these non-financial considerations against the financial benefits of saving tax. This is a very personal decision.

If you decide that you do want to move overseas, you should talk to a tax adviser before doing anything yourself. This is a complex area and you need to be sure that your future living and working arrangements achieve the tax savings that you desire.

TIP	Base yourself overseas if you work constantly overseas		
SAVE	£1,000's	**EASE OF USE**	Complex
What you need to do	Talk to a tax adviser about the best location for you		

17.2.6 National Insurance Contributions

Check what contributions you will have to pay if you work overseas

In broad terms, if you go and work in most European countries for a period of **more** than 12 months, you will immediately pay social security contributions in the country where you work. If you go and work overseas for **less** than 12 months, you will continue to pay National Insurance contributions in the UK.

ILLUSTRATION

*If you are working in Paris for two years, you will **immediately** stop paying National Insurance contributions, but you will pay "cotisations" (which sounds much better if you say it with a French accent), which is the name given to social security considerations in France.*

However, the rules are complicated, and you should take advice from the National Insurance Contributions Office ("NICO") before working overseas, so that you completely understand what social security contributions you will have to pay, and when.

If you are going to pay social security contributions in the country where you work, find out how much they are. They are not the same across Europe. For example, in France and Germany, you should expect to pay up to 50% more in social security contributions than you do in the UK.

TIP	If you are going to work overseas, check what social security contributions you will have to pay.		
BENEFIT	£1,000's	**EASE OF USE**	OK
What you need to do	Call the National Insurance Contributions Office ("NICO") Get a copy of Inland Revenue leaflet NI38, "Social Security Abroad" Get a copy of the Department for Work and Pension leaflet, SA29, "Your social security insurance, benefits and health care rights in the European Economic Area".		

Pay NICs to protect your UK state pension

If you do not pay National Insurance contributions, this may **affect your entitlement to state benefits**, such as pension, **in the future**.

If there is a chance that you will eventually return to the UK, you should consider paying Class 2 or Class 3 contributions to protect your pension (see 2.12 to remind yourself about Class 2 and Class 3 NI contributions).

You can take advice from the National Insurance Contributions Office, to understand what benefits you will be losing out on if you do not pay NICs for the time that you are overseas.

This is one of only a few occasions when you will find us recommending that you should consider paying more tax!!

TIP	Consider paying Class 2 or Class 3 NICs whilst you are working overseas to protect your pension benefits		
BENEFIT	£1,000's	**EASE OF USE**	Simple
What you need to do	Understand what benefits you are going to lose by not paying NICs (by talking to the NICO)		

17.2.7 Income from UK-based savings and investments

Get a refund for tax deducted at source

If you are non-resident in the UK, you only will be liable to pay tax in the UK on income that **"arises" in the UK**. This basically means that the asset which generates the income has to be located in the UK, e.g. an account with a UK bank or a share in a UK company.

In most cases, this income will be paid to you with tax already deducted at source.

If you are still entitled to claim personal tax allowances whilst you are overseas (see 17.6 below), you may be entitled to a refund of some or all of the tax that has been deducted at source.

The best way to claim this refund is by continuing to submit a UK Tax Return while you are overseas.

TIP	Get a tax refund for tax deducted at source on UK income		
SAVE	£100's	**EASE OF USE**	OK
What you need to do	Keep records of the income that you have earned and the tax that has been deducted at source. Complete a Tax Return		

Get a "credit" for foreign tax

You will normally be required to pay tax in the country in which you **are** resident.

If you are required to pay tax in the country in which you are resident on the income that you have earned in the UK, you may be able to claim a tax deduction in that country for the tax that you have paid in the UK.

This will depend upon whether the UK has something called a "Double Taxation Treaty" with the country in which you are resident.

TIP	Claim tax relief overseas for tax paid on your UK income		
SAVE	£100's	**EASE OF USE**	OK
What you need to do	Check with a tax adviser whether a Double Taxation Treaty is in force and whether you will be able to claim a deduction for any UK tax that you have paid. Keep records of the income that you have earned and the UK tax that you have paid, as you will need to show these to the tax authorities in the country in which you are resident to prove your entitlement to this "double tax" relief.		

17.2.8 Income from UK Property

If you rent out your UK home while you are working overseas, you will be liable to pay UK income tax on the **profits** that you make even if you are **not resident for UK tax purposes**. These profits are calculated in the same way as they would be if you were resident in the UK (see 9.3).

Get a refund of tax deducted at source

If you use a Managing Agent to look after your rented UK property while you are away, the Agent will deduct basic rate tax before paying the rent to you (which means that you will only receive 78% of the gross rent). This deduction is effectively a payment on account of the tax that you are due to pay on your rental profits for the year.

You will have further tax to pay if the tax bill on your rental profits is more than the tax that has been deducted at source.

However, you will be able to;

- Get a refund for **some** of the tax deducted at source **if** the total tax deducted is more than your UK tax bill for the year,

- Get a refund for **all** of the tax that has been deducted at source if your rental profits plus any other UK taxable income are less than the tax allowances that you are entitled to claim.

You will have to complete a Tax Return to get a refund of any tax that you have effectively overpaid.

It is ***very likely*** that you will be in a position to claim a tax refund, as the tax that is deducted at source is calculated based on your rental ***income***, whereas your actual tax bill will be based on your rental ***profits***. Profits are likely to be a lot less than income!

TIP	If tax is being deducted at source from your UK rental income, make sure that you submit a Tax Return, so that you can get a refund for some (or all) of the tax deducted at source from the rents on your UK property
What you need to do	Complete a Tax return

Receive gross rental income

You can apply to the Revenue for a certificate that authorises your tenant or Managing Agent to make payments of rent to you ***without*** deducting any UK tax at source (i.e. you will receive the gross rent).

The Revenue will allow you to receive UK rents without a deduction for tax if;

- You do not expect to have a UK tax bill for the year in which the application is made,

- You have complied with your UK tax obligations up to the date of application, and

- You undertake to comply fully with Self Assessment (which will require you to file an annual Tax Return)

TIP	Get UK rental income paid to you without any tax deduction		
BENEFIT	£1,000's	**EASE OF USE**	Simple
What you need to do	Talk to the Revenue before you go overseas and ask them for		

17.3 Investing Overseas

Figure 17 illustrates the tax treatment of **income** and **gains** from **overseas** (or "foreign") investments.

If you have to pay tax on **foreign investment income**, it is added to any UK income of the same type and taxed at the same rate (see 2.9).

*The exception to this rule is any investment income which is taxed when it is brought into the UK. As Figure 17 shows, this applies when you are resident but not domiciled in the UK. Under these circumstances, any foreign investment income is taxed **as if it was earnings** (i.e. non-savings income).*

If you have to pay tax on **foreign capital gains**, they are taxed in the same way as UK capital gains (see Section 19).

*The exception to this rule is any gains from investments in offshore funds, which are taxed **as if they were investment income**, **unless** the fund has something called "distributor status", in which case the gains will be **taxed as capital gains**. The fund manager will be able to tell you which rule applies to your particular investment*.

17.4 Foreign tax relief

You may find yourself in a position where you have to pay tax both in the UK **and** overseas on **foreign income and gains**.

If this is the case, you are allowed to claim relief for this "double taxation" in one of two ways;

- You can pay UK tax on the **net amount** that you have received (i.e. the gross income or gain less any foreign tax payable); or
- You can claim **tax credit relief**, which is a deduction from your UK tax bill equal to the lower of;
  - the UK tax payable on the foreign income, or
  - the foreign tax payable on the foreign income

  This means that your foreign income will be taxed at the higher of the UK tax rate or foreign tax rate.

Usually, the second option, tax credit relief, saves you the most tax, although **this can only be claimed if you are resident in the UK for tax purposes.**

EXAMPLE

Kieron Heskey, a basic rate taxpayer, has earned gross interest of £1,100 from a deposit in a foreign bank account in 2004/05.

Tax of 10% has been deducted at source, so Keiron actually received £990.

Kieron can either;

- Pay UK tax at 20% on the net amount received, being 20% of £990, which is £198; or

- Pay UK tax at 20% on the gross amount of £1,100, being £220, and claim tax credit relief for the foreign tax of £110, giving a net UK tax payable of £110.

By choosing to claim tax credit relief, Kieron will pay £88 less tax.

TIP	Claim tax credit relief where you have to pay foreign tax on foreign income		
SAVE	£1,000's	**EASE OF USE**	Simple

What you need to do	You will need to fill in the two tables on page F3 of your Tax Return (making sure that you tick the end box to claim foreign tax credit relief). If you work out your own tax, you will also need to fill in boxes 6.9 and 6.10. If you are unsure about what to do, read the notes to the Foreign pages of the Tax Return and use the blank working sheet provided with these notes to get the figures right before you put them on your Return. If you have made a foreign gain, you may want to get a copy of help sheet IR261 from the Inland Revenue, "Foreign Tax Credit Relief: Capital Gains".

17.5 "A Place In The Sun"

Your UK tax status will determine to what extent you are taxed in the UK on ***the profits*** that you make from renting out Overseas property – refer to Figure 17 above.

In calculating these profits, you should note that you are **not entitled** to;

- Rent-a-room relief, or

- Use the special tax provisions that apply to "furnished holiday lettings" (see 9.3.4 above),

as these apply **only to UK properties**.

You **can** claim a tax deduction for the interest that you pay on a loan you have taken out to buy a property (reduced, as appropriate, to take account of any private use of the property).

If you rent out property in the UK **<u>and</u>** Overseas, the Revenue will treat this as two separate businesses. As such;

- You must calculate separately your UK rental profit and your Overseas rental profit. As such, you cannot claim a tax deduction for your UK expenses against your Overseas rental income (and vice versa).

- If you make a loss on the rental of your overseas property, you **cannot** use this to reduce your UK rental profits (the loss must be carried forward and offset against any future Overseas rental profits). This applies equally if the circumstances were reversed and you made a UK rental loss and an overseas rental profit

Remember: You will probably also have to pay tax in the overseas countries in which your properties are based, although in most cases you will be able to claim relief in the UK for any foreign tax that you pay (see 17.4).

TIP	Be clear about the local tax position before you buy an overseas property and confirm whether you will be able to offset any foreign tax that you pay against your UK tax bill.		
SAVE	£1,000's	**EASE OF USE**	Difficult
What you need to do	Take advice from a tax adviser.		

17.6 Tax Allowances

17.6.1 Claim UK tax allowances while you are overseas

The standard Tax Allowances, as listed in 2.4, are given to every man, woman and child who is resident in the UK.

However, even if you are **not resident** in the UK, you can **still claim UK tax allowances <u>if</u>** you fall into one of the following categories:

- a Commonwealth citizen (this includes a British citizen) – this is generally taken to mean someone who is resident in a Commonwealth country,
- a citizen of a state within the European Economic Area (EEA),
- a present or former employee of the British Crown (civil servant, member of the armed forces, etc.),
- a UK missionary society employee,
- a civil servant in a territory under the protection of the British Crown,
- a resident of the Isle of Man or the Channel Islands,
- a former resident of the UK and you live abroad for the sake of your own health or the health of a member of your family who lives with you,
- a widow or widower of an employee of the British Crown,
- a citizen of Bulgaria or Israel (so that's going to help a lot of you!),
- an individual who does not fall within the above categories but is entitled to claim by virtue of the conditions of a Double Taxation Agreement which the UK may have with his or her country of residence. Depending on the precise terms of the Agreement concerned, such an individual may be entitled to claim either as a resident national of the other country or merely as a resident of the other country.

If you earn UK income while you are non-resident, these allowances will reduce your liability to tax in the UK.

TIP	Claim full tax allowances while you are non-resident.		
SAVE	£1,000's	**EASE OF USE**	Simple

17.6.2. Get your full tax allowances in the year of arrival and departure

If you become, or cease to be, **resident** in the UK during a tax year, you will be able to claim **full allowances** and reliefs for the year of arrival or departure. The allowance is **<u>not</u>** time apportioned.

ILLUSTRATION

If you leave the UK on 1st October 2005 to work overseas for 4 years in the US, you will be entitled to claim a full personal tax allowance of £4,895 for 2005/06, which you can offset against any UK income in the year.

TIP	Claim full tax allowances for the year that you become non-resident in the UK.		
SAVE	£1,000's	**EASE OF USE**	Simple

17.6.3 Claim your annual CGT allowance when you are overseas

You receive your annual capital gains tax allowance (see 19.1) **irrespective of where you are resident for tax purposes**.

ILLUSTRATION

If you made a capital gain of £15,000 on the sale of a UK asset on 15th November 2005, whilst you were non-resident, you would be entitled to claim a deduction of £8,200 for your annual CGT allowance. Your taxable gain in 2005/06 would therefore be £6,800.

TIP	Claim your annual CGT allowance as a deduction from any capital gains that you make on UK assets whilst you are non-resident		
SAVE	£1,000’s	**EASE OF USE**	Simple
CONSIDER	You will not have to pay any capital gains tax on the disposal of a UK asset if you make the disposal during a period of 5 consecutive tax years when you are neither resident nor ordinarily resident. This is discussed later in 19.26.		

17.7 Dealing with the Inland Revenue

17.7.1 Completing a Tax Return

You need to tell the Inland Revenue by 5th October following the end of the tax year of any foreign income or gains that you have received that are taxable in the UK.

This will require you to fill in the following pages on your Tax Return;

- The Employment or Self-employment pages for income that you have received from working abroad,
- Box 6.9 in the Foreign pages of your Return if you wish to claim foreign tax credit relief on your income,
- Box 6.10 in the Foreign pages of your Return if you wish to claim foreign tax credit relief on your gains
- The Capital Gains pages for any taxable overseas capital gains,
- Question 6 on page 2 of the main Tax Return if you have received any other foreign income, along with the relevant pages of the Foreign pages.

If you are claiming that you are non-resident or non-domiciled in the UK, you must tick the relevant boxes on the “Non-residence” pages of the Tax Return as well as Question 9 on page 2 of the main Tax Return.

If you are not sent a Tax Return, or you are sent a Tax Return without the relevant Supplementary pages, call the Inland Revenue order line on 0845 900 0404.

TIP	Make sure that you fill in your Tax Return correctly for all foreign income and gains that are taxable in the UK		
SAVE	£100	**EASE OF USE**	Simple

17.7.2 Submit a Form P85

We suggest that you send a Form P85 to the Revenue when you leave the UK, asking for confirmation of your tax status whilst you are overseas.

By doing this, you will get early warning of the Revenue’s position and have the time to make any changes to your working/living arrangements in order to maximise the tax benefits of working overseas.

TIP	Send Form P85 to the Revenue when you leave the country to see whether they will regard you as non-resident for tax purposes while you are overseas		
SAVE	£1,000’s	**EASE OF USE**	Simple

17.8 Relevant Tips elsewhere in the book

19.26. Avoid Capital Gains Tax on the sale of UK assets when you are overseas

18 PENSIONS

You should read this Section if you want to understand how you can save tax by making pension contributions.

We recommend that you read this Section even if you are already making contributions.

In this Section you will learn;

- **Why saving for your pension is one of the best ways for you to save tax**
- **How to maximise the amount that you can contribute tax-free to your pension**
- **About Additional Voluntary Contributions and how you can use them to reduce your tax bill**
- **When you should consider deferring your State Pension**
- **Why both you and your employer will save tax if you take extra pension contributions rather than extra salary**
- **About recent changes to the way in which pensions will be taxed, and what these mean for you**

18.1 Introduction

Generally speaking, you get a tax deduction for money that you put into a pension, but you are taxed on money that you receive from a pension. This includes most state pensions.

There are two main types of pensions savings schemes;

- "**Occupational pension schemes**" that are run by companies for the benefit of their own employees;
- "**Personal**" pension plans that are taken out by individuals. A "Stakeholder" pension plan is a type of personal pension plan.

The publishers of "Cut Your Tax Bill"™, Churchill Lloyd Publications, also produce a Guide to Pensions, which you can download for **FREE** if you provide feedback on this book via the Cut Your Tax Bill website (click on the "Feedback/Contribute" button on the home page and follow the instructions). If you are not sure of the various types of pension that are available to you, and the different rules relating to each type, it would be worth your while downloading this Guide after you have finished reading this book.

With certain exceptions, you cannot make payments (called "contributions") to both types of scheme **at the same time** (but you **can** pay contributions to each type of scheme throughout your working life).

Pensions are exceptionally tax effective because;

- **You get full tax relief on the contributions** that you pay – this means that pension contributions are a tax deductible cost (up to certain limits, which are described below)
- **Your pension fund grows in value largely free of tax**
- When you retire, **you can take a tax-free lump sum** in exchange for giving up some of your annual pension.

The **tax relief** is given in slightly different ways for contributions to occupational pension schemes and contributions to personal pension plans;

- **For contributions to an occupational pension scheme**, your employer will deduct your pension contributions from your gross pay and then work out what tax you should pay on the balance. Your take home pay will **reduce**, but **not** by the full amount of the pension contribution;

    - **if you are a basic rate taxpayer**, your take home pay will reduce by £78 for every £100 that you contribute to the pension scheme - as you are effectively paying £100 to your pension and reducing your tax bill by £22; and

    - **if you are a higher rate taxpayer**, your take home pay will reduce by £60 for every £100 that you contribute to the pension scheme– as you are effectively paying £100 to your pension and reducing your tax bill by £40.

- **For contributions to a personal (or stakeholder) pension,** you will make the payments out of your take home pay and**;**

    - **If you are a basic rate taxpayer**, for every £78 that you contribute to a personal (or stakeholder) pension, the government will contribute a further £22 (which is claimed from the government by the pension company). Thus, a £100 contribution to your personal pension will cost you £78.

    - **If you are a higher rate taxpayer**, for every £78 that you contribute to a personal (or stakeholder) pension, the government will contribute a further £22 (claimed from the government by the pension company) **and** you can claim a reduction in your tax bill of £18. Thus, a £100 contribution to your personal pension will cost you £60.

The benefits and the tax savings are significant.

TIP	Making pension contributions is not only important for your future financial security, it is also one of the best ways of saving tax		
SAVE	£1,000's	**EASE OF USE**	Simple
What you need to do	If your employer has an occupational pension scheme, it is generally advisable to join it. However, read 18.4 below first. If your employer does not have an occupational pension scheme, you should contribute to a personal pension plan. Talk to an IFA about the plan that might be right for you.		

IMPORTANT: On 6th April 2006, the Government changed the tax rules governing pensions. The changes were significant and are explained in detail in Paragraphs 18.16 onwards. Paragraphs 18.2 and 18.7 below relate to the rules that existed prior to 6th April 2006, but they have been included in this Guide for those people who want to review their previous tax returns.

18.2 Maximum annual contribution limits (OLD PENSION RULES)

Up until 5th April 2006 there was a **maximum level of contributions** that you were allowed to pay **tax-free** into a pension each year. You could pay more than this, but you did not get a tax deduction for any "excess" contributions (over your maximum permitted level).

The maximum annual level of contributions was based on a percentage of your "net relevant earnings" in that year (up to a maximum level, which was £105,600 for 2005/06 and was £102,000 for 2004/05).

"Net relevant earnings" was defined as the total of;

- **income from employment** (**including** the annual amount of any taxable benefits and **less** any tax deductible costs), **plus**

- any **taxable profits from self-employment** (**after** deducting capital allowances **and** losses brought forward from previous years).

It **excluded** income from savings and investments.

The percentage of your net relevant earnings that you were allowed to contribute to a pension, and get a tax deduction for, varied according to your age and the type of pension that you are investing in – see Figure 18 below.

Figure 18: Percentage of net relevant earnings allowed as tax-free pension contributions

	% of earnings	
Age at the start of the tax year	**Personal Pension and Occupational Pension Schemes**	**Retirement Annuities[19]**
35 or less	17.5	17.5
36 – 45	20	17.5
46 – 50	25	17.5
51 – 55	30	20
56 – 60	35	22.5
61 – 74	40	27.5

By multiplying the relevant percentage from Figure 18 by your "net relevant earnings" you calculated the maximum gross pension contributions that you could make "tax-free" in a tax year. **IMPORTANT NOTE**: This calculation derived your maximum **GROSS** pension contribution.

ILLUSTRATION

A 52 year-old man who had net relevant earnings of £30,000 could make gross tax-free pension contributions to a personal pension plan of up to £9,000 (being 30% x £30,000) in the tax year. To make gross contributions of £9,000, the man would only have had to pay contributions of £7,020 (as the Government would have contributed the extra £1,980 directly to his personal pension plan).

[19] See 18.14 for an explanation of Retirement Annuity Plans

TIP	Up to 5th April 2006, contribute as much as you can to your pension, taking as much advantage as you can of the maximum "tax-free" contribution level		
SAVE	£1,000's	**EASE OF USE**	Simple
What you need to do	Calculate your maximum gross tax-free pension contribution by estimating your "net relevant earnings" for the tax year and using the relevant percentage from Figure 18 above. Work out how much you can comfortably contribute to a pension in a year, whilst still leaving you with adequate funds to pay your bills and meet the costs of your standard of living. This is your desired **net** pension contribution. Convert this into a desired **gross** pension contribution by multiplying it by 100/78. If your desired gross pension contribution is; • **less** than your maximum gross tax-free pension contribution, you should pay over your desired **net** pension contribution into your pension plan. • **more** than your maximum gross tax-free pension contribution, you must decide whether you want to either; (i) pay your desired net pension contribution despite the fact you will not get a tax deduction for the full amount, or (ii) pay your maximum net tax-free pension contribution (which you can calculate by taking your gross tax-free pension contribution and multiplying it by 78/100). Ideally, you should pay any amounts into your pension gradually over the course of the year. Monthly direct debits are an ideal way of making regular pension contributions.		

18.3 Net Relevant Earnings (OLD PENSION RULES)

The "net relevant earnings" that were used for the purposes of calculating the maximum level of contributions for a tax year were those for that tax year **or any of the preceding five tax years**. The year that is chosen could be changed at any time.

This is a particularly useful rule, as it allowed you to take advantage of when your earnings fluctuated significantly from year to year, for example if you are self employed.

EXAMPLE

Paul James is a bricklayer and in 2004/05 he made taxable profits of £25,050. Paul is 52 and he is contributing to a personal pension plan. In the last 5 tax years, his taxable profits were;

2003/04	*35,755*
2002/03	*12,240*
2001/02	*39,330*
2000/01	*24,230*
1999/00	*29,005*

Paul has no other income and his taxable profits are therefore his "net relevant earnings" for pension contribution purposes. Paul can choose £39,330 as his "net relevant earnings" for 2004/05 (as this is within the last 5 tax years) and the maximum level of gross tax-free pension contributions that Paul can make in 2004/05 is therefore 30% (from Figure 18) x 39,330 = £11,799

The Government will contribute 22% of this amount (being £2,596), so if Paul wants to pay the maximum amount into his personal pension, tax-free, he will have to contribute £9,203 himself.

TIP	Base your pension contributions for the current year on your highest level of net relevant earnings for the current tax year and the preceding 5 years		
SAVE	£1,000's	**EASE OF USE**	OK
What you need to do	Calculate your net relevant earnings for the current tax year and the 5 previous tax years. Take the highest of these six figures and then apply the relevant percentage from Figure 18 above. This gives the maximum level of pension contributions that you can make tax-free in the current tax year.		

18.4 Carry forward unutilised limits (OLD PENSION RULES)

If you did not use your maximum tax-free pension entitlement in one tax year (turn back to Figure 18 if you cannot remember the maximum limits), you could use this "unused entitlement" in the next year (**in addition to** your tax-free entitlement for that year).

In order to do this, you needed to;

- **Make an election** (by writing to the administrator or manager of your pension) to "carry back" pension contributions to the previous tax year. This election had to be made before, or at the time, that the contributions were paid

- Make a payment of pension contributions to use up the unused entitlement **by 31st January** (if you did not make a payment by 31st January, you "lost" the unused entitlement)

If you paid tax at a higher rate in the previous tax year, you also needed to complete and submit an Inland Revenue form PP43.

EXAMPLE

Sol Cole, an interior designer who was 36 in September 2004, earned the following taxable profits from his business in his first 6 years of trading;

2004/05	*25,675*
2003/04	*32,235*
2002/03	*24,000*
2001/02	*34,750*
2000/01	*22,005*
1999/00	*19,550*

Sol started a personal pension plan on 6th April 2003, making regularly monthly contributions of £150 a month. In May 2004, Sol was left £10,000 by his mother in her will and he wanted to invest as much as he could of this sum tax-free into his pension. This is calculated as follows;

2003/04

His net relevant earnings are £34,750 (the highest taxable profits in the last 6 years) and his relevant percentage is 17.5% (he was 34 at the start of this tax year), giving him an annual tax-free pension contribution limit of £6,081. He also has an unused pension limit from 2002/03 of £6,081 (he made no pension contributions before 6th April 2003).

The first 9 monthly pension contributions of £150 (£192.31 gross) in 2003/04 can be offset against his "brought forward" 2002/03 allowance. At this stage (31st January 2004), the rest of this unused allowance is lost.

Sol's remaining 3 monthly contributions in 2003/04 therefore go against his 2003/04 allowance of £6,081, leaving £5,504 unused and available to be carried forward to 2004/05.

2004/05
His net relevant earnings are still £34,750 and his relevant percentage is still 17.5% (he was 35 at the start of this tax year), giving him a new annual tax-free pension contribution limit of £6,081.

He has an unused pension limit from 2003/04 of £5,504, which he has to use up by 31st January 2005. His total pension contribution limit for 2004/05 is therefore £11,585 (being £5,504 plus £6,081).

Sol's net monthly contributions of £150 per month equate to £1,800 for the year (or £2,307 gross). Deducting this from his 2004/05 limit gives a "surplus" gross entitlement of £9,278. This equates to a net contribution of £7,236.84.

Sol can therefore contribute £7,236.84 of the £10,000 left to him by his grandmother to his pension tax-free. He will have to invest this by 31st January 2005, otherwise he will "lose" the unused entitlement from 2003/04.

If you had the money, it was advisable to use up all of your "tax-free" pension entitlement - this was one of the most tax-efficient means of saving for the future.

TIP	Use up unused pension limits from the previous tax year		
SAVE	£1,000's	**EASE OF USE**	OK
What you need to do	Follow the steps outlined above. In terms of your Tax Return; • If you elected to carry back pension contributions from the current tax year to the previous tax year, to use up your unused tax-free pension limit from that year, you needed to fill in box 14.7		

18.5 Low earners (OLD PENSION RULES)

If you were under 75, you were allowed to contribute up to **£3,600 per year** (gross) into a personal or stakeholder pension plan **irrespective** of how much you earned in the tax year **unless** you were also contributing to an Occupational Pension Scheme.

If you were also contributing to an occupational pension scheme, you could only pay into a personal pension plan as well if;

- You earned less than £30,000 a year in **every year** since 5th April 2000, and you were not a controlling director[20] of the company that employs you; **or**

- You had "net relevant earnings"[21] from other work (i.e. not from the employer to whose occupational pension scheme you were contributing), or the occupational pension scheme to which you were contributing provided only death benefits, or the personal or stakeholder pension was "rebate-only"[22].

In simple terms, these rules allowed;

- people who were consistently earning less than £30,000 a year to contribute to a personal pension plan **as well as** contributing to an occupational pension scheme

- workers with more than one source of income to contribute to a personal pension plan as well as an occupational pension scheme

- people who were taking a career break to put money into a pension and benefit from the tax advantages that pensions savings provided. Whilst this did **not reduce your tax bill** in the year (as you would not have been paying tax), you benefited because the Government "topped up" your pension contributions for you. As such, you were better off.

[20] Being a director who, together with his family and associates, owns or controls more than 20% of the company's share capital
[21] See 18.3
[22] The only contributions being put into it are the National Insurance rebates provided by the Government for not participating in (or "opting out" of) the State Second Pension.

EXAMPLE

Tracey Neville has spent the last 8 years as a full-time housewife, looking after her 3 kids. On 1st November 2004, Tracey won £10,000 on the Lotto and she decided that she would like to put as much as possible into her personal pension.

She is allowed to put £2,808 into her personal pension in 2004/05, to which the Government will contribute a further £792 (making the £3,600 ***gross*** *contribution that she is allowed to make in 2004/05).*

In addition, she is allowed to pay a further £2,808, to use up her unused pension limit from 2003/04, as long as she pays this amount into her pension before 31st January 2005 (see 18.5 for explanation).

Tracey could therefore contribute £5,616 into her personal pension, tax-free, in 2004/05, and the Government would contribute a further £1,784 on her behalf.

- parents and grandparents to put aside money in a personal pension plan for children and grandchildren.

TIP	If you can afford it, make use of the fact that the Government allows you to contribute to a personal pension plan in certain "special" circumstances. If you do so, the Government will effectively contribute 22% towards your future pension (or that of your children or grandchildren).		
SAVE	£100's	**EASE OF USE**	OK
What you need to do	Fill in box 14.6 of your Tax Return (and box 14.7 if you are using up any unused pension entitlement from the previous year).		

18.6 Anti-avoidance rules (OLD PENSION RULES)

The old rules prevented people from contributing to a pension just to get the tax relief. For example;

- You could not take money out of a pension scheme **before you reached a certain age** (which was **60 for an occupational pension scheme or retirement annuity pension** or **50 for a personal pension**),

- You could not draw your pension from an occupational pension scheme whilst **you were still working for that employer,**

- The pension payable by a "final salary" occupational pension schemes was limited to **2/3rds of your final salary,**

- You were allowed to take part of your pension as a lump sum, but the amount that you could take was **restricted** and the balance of your pension money **had** to be used to buy an annuity when you retired (an annuity is a guaranteed income for life provided by an insurance company in return for the payment of an up-front lump sum).

You were allowed to get a **refund** from an occupational pension scheme of any amounts that you had contributed **if** you have been a member for less than 2 years, but this refund was paid to you less 20% tax. If you were a higher rate taxpayer, you had to pay a further 20% tax by 31st January after the end of the tax year in which you received the refund.

There were no loopholes that allowed you to contribute to a pension scheme, get tax relief on these contributions, and then immediately get access to these tax-free funds.

TIP	Be aware of the anti-avoidance rules

18.7 Retirement Annuity Pensions (OLD PENSION RULES)

Retirement Annuity Pensions ("RAPs") existed prior to Personal Pensions – in the good old days they were a means of saving for retirement if you did not belong to an occupational pension scheme.

Since July 1988, it has not been possible to start a RAP, but many people continue to contribute to RAPs that they started before then.

There were two key differences between the tax treatment of RAPs and Personal Pensions. These differences related to;

- The treatment of unused tax-free pension contribution limits, and
- The calculation of "net relevant earnings"

Treatment of Unused contribution limits: If you had not been making the maximum tax-free contributions to your RAP (see Figure 18 above), you were allowed to **carry forward** any unused entitlement for a period of **6 years**.

This allowed you to make a substantial one-off, tax-free, contribution to your RAP in future years.

TIP	Make use of the 6 year carry forward for unused tax-free pension contributions		
SAVE	£1,000's	**EASE OF USE**	OK
What you need to do	Keep a record of your unused tax-free entitlement Fill in box 14.3 on your Tax Return with any pension contribution payments that you want to offset against unused entitlement from previous years		

Calculation of Net Relevant Earnings: There was **no maximum earnings limit** applicable to the calculation of the maximum annual tax-free contributions to RAPs. The amount that you could pay into your RAP each year was determined only by your age and your earnings (see Figure 18 above).

TIP	RAPs allow you to contribute much more to your pension, tax-free, compared to normal Personal Pensions. This is of particular benefit to high-income earners.		
SAVE	£1,000's	**EASE OF USE**	Simple
CONSIDER	If you have a RAP, keep contributing to it, as it has significant tax advantages over a Personal Pension.		

18.8 Occupational Pension Schemes

If your employer provides an occupational pension scheme, it is **normally advisable to join it**.

Not only do you benefit from the tax advantages that we have described above, but **also** your employer will make contributions to the pension scheme on your behalf**.** These contributions are made **in addition to** your salary.

EXAMPLE

David Robinson earns £30,000 a year. His employer, Bulldozer plc, provides a pension scheme which David wants to know whether he should join.

Under the terms of the scheme, the employee is required to contribute 4% and Bulldozer contributes 8%.

If David joined the scheme, £3,600 a year will be put into his pension (£1,200 by him and £2,400 by his employer), and his net take home pay will reduce by £936.

David would therefore be advised to join the scheme (as, overall, he is £2,664 better off) ***as long as*** *he can still meet his living expenses out of his slightly reduced take home pay.*

The bottom line is that, if you do not join your employer's pensions scheme, you are effectively turning down an increase in salary!

However, you should not join your employer's occupational pension scheme just because of the tax breaks. In the light of Robert Maxwell and the Mirror Group pensions debacle, you should also consider the security of your pension and make sure that you have answers to the following important questions before you join;

- Where is your pension money invested by your employer?
- Who decides where the pension money is invested?
- Who is on the Board of Trustees that controls the Pension scheme?
- Is your employer up to date with contributions to the pension scheme?
- If the pension scheme is a "defined benefit" scheme, is it fully funded?
- Does the pension scheme produce accounts that are independently audited? If so, does the audit opinion draw the attention of the members of the scheme to anything untoward?

When you have the answers to these, and any other questions that are important to you, you can decide whether you are happy to join your employer's pension scheme, or whether you would prefer to contribute to your own personal pension even though your pension contributions and tax savings will be lower.

TIP	Join your employer's pension scheme, as long as you are happy to do so.		
RECEIVE	£1,000's	**EASE OF USE**	Simple
What you need to do	Talk to your employer's personnel manager and fill in a couple of forms		

18.9 Additional Voluntary Contributions

If you belong to an **occupational pension scheme**, your contribution rate will be fixed by the scheme's Trustees.

However, you can add to (or "top up") your contributions by paying **Additional Voluntary Contributions** (AVCs), **either** into the scheme itself, or on a "free standing" basis to an Insurance or Pension company.

You get tax relief for AVCs in the same way as normal pension contributions, **as long as** the total of all of your pension contributions in a tax year does not exceed your permitted limit (based on your net relevant earnings and your age – see Figure 18 above).

TIP	If you can afford to contribute more than you are required to do so by your employer, and your contributions do not use up all of your "tax-free" limit, you should pay AVCs		
SAVE	£1,000's	**EASE OF USE**	Simple

What you need to do	Calculate your maximum permitted level of contributions using Figure 18 above and by estimating your "net relevant earnings" for the tax year Calculate how much you are already contributing to your employer's pension scheme Work out how much more you can comfortably pay for AVCs, whilst still leaving you with adequate funds to pay your bills and meet the costs of your standard of living Pay this amount or, if less, the amount that takes your total annual contributions up to your maximum permitted level of contributions, in AVCs. Talk to an IFA about whether you should pay these AVCs into your employer's pension scheme, or whether you should pay them on a "free standing" basis to an Insurance or Pension company. In terms of your Tax Return; • You should fill in box 14.11 with the gross value of any free-standing AVCs that you have paid in the tax year, • You do not need to fill in any boxes on your Tax Return for pension contributions that you have paid to your employer's pension scheme

18.10 State Pension

18.10.1 Defer your State Pension

You do not have to take your State pension.

Indeed, you should consider not taking it if receiving it would push you into a higher tax bracket or would reduce your age-related tax allowances (as described in 6.1).

As a general guide;

- You will effectively only receive 60% of your state pension if it pushes your income above higher rate threshold; and

- You will effectively only receive 89% of your state pension if it pushes your income above the income limit that is applied to age-related tax allowances.

If you delay taking up your state pension, you will receive a higher state pension when you eventually receive it. For each year that you delay taking up your pension, you will get around 7.5% extra on top of the standard pension.

TIP	Defer your state pension		
SAVE	£100's	**EASE OF USE**	OK

CONSIDER	You should probably **not** defer your state pension if; • you don't expect your income (excluding your state pension) to reduce significantly in the next couple of years), or • you expect this income to reduce, but it will still be above the higher rate tax threshold. If you expect your income to reduce **and** it will be below the higher rate threshold, you will need to weigh up the tax that you will save by deferring your pension, against the fact that you will have less money to spend until such time as you start to take your pension.
What you need to do	If you want to defer your State Pension, call the National Insurance Contributions Office on 0191 213 5000.

18.10.2 Married Woman's pension

If you are a married woman who has paid reduced NI contributions for part of your working life ("the married woman's NI stamp"), you are able to get a state pension based on your husband's contributions once he reaches 65.

This pension will be worth significantly more than the pension that you will get based on your own contributions.

In order to claim this higher pension, contact the National Insurance Contributions Office on 0191 213 5000. Have your National Insurance number to hand, as well as that of your husband, when you make the call.

TIP	If you have paid the "married woman's NI stamp" in the past, claim your pension based on your husband's NI contributions once he reaches the age of 65.		
SAVE	£100s	**EASE OF USE**	Simple
What you need to do	Call the National Insurance Contributions Office on 0191 213 5000		

A woman's pension position becomes much more complicated when she is widowed, or has re-married, and, in these circumstances, we suggest that you speak to the Citizen's Advice Bureau, or a welfare rights advisor, to make sure that you are receiving your maximum state pension.

18.11 Overseas Pensions

You will pay tax on only 90% of pensions that you receive from overseas governments through an agent, officer or public department of that government, **if** you are;

- A person who has been employed in the Service of the Crown or the Government of the overseas country concerned; or
- That person's widow, widower, child, relative or dependent.

On your Tax Return, you should report the full amount of the pension that you received in the tax year as income, but then claim a 10% deduction in box 11.13 of the main Tax Return.

TIP	Claim a 10% deduction for overseas pensions		
SAVE	£100's	**EASE OF USE**	Simple
What you need to do	Calculate 10% of the pension that you have received and put this number in box 11.13 on your Tax Return		

18.12 "Ill-health" pensions

The general rule, as we have said before, is that amounts that you receive from a pension is taxable.

However, if you receive a pension as a result of an injury that you received at work, or a work related illness, the extra pension (the amount over and above what you would have got if you had retired on ordinary ill-health grounds) **is not taxable** and does **not** need to be included in boxes 11.10 to 11.12 on your Tax Return.

TIP	Don't get taxed on a pension that you are receiving because of a work related injury or illness		
SAVE	£100's	**EASE OF USE**	Simple
What you need to do	Find out how much extra pension you are receiving because of a work-related injury or illness and do not include this within the sums that you put into boxes 11.10 to 11.12 on your Tax Return		

18.13 Take pension rather than salary

If you are offered the choice, and you are living comfortably on your existing take home pay, you should **always** opt for more pension rather than an equivalent amount in extra salary.

Not only will you save tax, but your employer will also save National Insurance contribution payments.

With a little persuasion, your employer *may* even pass this saving on to you in the form of a higher payment into your pension.

ILLUSTRATION

Giving you an extra £150 a month in salary, costs your employer the same as putting an extra £169 per month into your pension.

TIP	Opt for higher employer pension contributions rather than the same increase in salary		
SAVE	£100's	**EASE OF USE**	Simple
CONSIDER	Asking your employer to pass their tax saving on to you by way of even higher pension contributions		

18.14 Tax Return

If you are claiming tax relief for pension contributions made during the year, you should ensure that your date of birth is entered in box 22.6 of the Tax Return.

TIP	Make sure that your date of birth is included in box 22.6 of the Tax Return

18.15 Advanced pension strategies

18.15.1 SSAS

If you are a director of a company, or you run a family business, you would probably benefit from a Small Self Administered Scheme (SSAS).

What is a SSAS?

A SSAS is a private pension scheme that operates as a private, self-administered trust, which is designed to provide pensions and other benefits for the owners/directors of small to medium-sized companies. Only one SSAS is permitted per company.

Who can have a SSAS?

SSASs are limited to twelve members, one of whom must be a professional trustee who is there to ensure that any investment rules and regulations are not breached.

The owners/directors of limited companies are the normal trustees of a SSAS, but spouses and children of company directors may also become trustees, provided they are employed by the company.

What are the advantages of having a SSAS?

The main advantage of an SSAS over more traditional types of pension arrangement is that the directors (or more accurately the trustees, since a SSAS is a trust) *keep control of the scheme's assets at all times*, in contrast to normal pension arrangements where a scheme's assets are held and controlled by an insurance company.

Moreover, the trustees of the SSAS have a wide range of investment powers which allow the funds to be invested in company shares, gilts and bonds, bank and building society deposit accounts, commercial property, and so forth. This compares with insurance company pension schemes, in which pension fund assets are normally invested in the insurance company's own funds. The ability to direct the investment of the fund, particularly into *areas that can benefit one's own company* (known as "self-investment"), is a key appeal of an SSAS.

In fact, self-investment through a SSAS may be a vital source of finance for a growing company. The following forms of self-investment are possible: loans to the company, the purchase of commercial property from the company, or on behalf of the company; and purchase of the company's own shares.

18.15.2 SIPP

If you want to control your own investment strategy, while still enjoying the benefit of the tax shelters afforded by a pension scheme, you may wish to consider a Self Invested Pension Portfolios (SIPP).

This operates in the same way as a conventional personal pension in respect of contributions and eligibility, but allows you to have control over the investments made with the pension contributions.

These are complex products and, if you are interested in them, you should consult with an IFA.

TIP	Talk to an IFA about SSAS and SIPPs		
SAVE	£1,000's	**EASE OF USE**	Complex

18.16 Recycle pension lump sums

It is perfectly legitimate to take out a tax-free cash lump sum from one pension fund and re-invest up to 30% of the lump sum – up to a maximum of £15,000 - in another pension fund, and get tax relief on this re-investment.

For example, it is possible to withdraw £50,000 from a pension fund in cash, tax-free, and re-invest £15,000 in another pension. The government will "gross up" this pension contribution by a further £4,230 and the taxpayer would get a reduction in his tax bill of £3,461.

Thus, the taxpayers total pension funds will only have reduced in value by £30,770 and the taxpayer will have £38,461 cash in hand.

TIP	Talk to an IFA about recycling pension lump sums		
SAVE	£1,000's	**EASE OF USE**	Complex

18.17 Changes to the tax treatment of Pensions

From 6th April 2006, the Government has changed the way in which Pensions are taxed.

The main changes were as follows;

- You can now join **any number** of pension schemes **at the same time,**
- You can get tax relief on contributions equivalent to your annual salary each and every year - up to a current maximum of £215,000 (although this rises gradually to £255,000 in 2010/11), or up to £3,600 a year if you have no earnings,
- There is a "lifetime allowance", which caps the tax-free value of a retirement fund. This is set at £1.5 million from 6th April 2006, rising gradually to £1.8 million in 2010/11. The lifetime cap applies to all pensions, in aggregate.
- You are allowed to take up to 25% of the value of your pension savings at retirement tax-free,
- Your pension plan will be allowed to borrow up to 50% of the value of its assets,
- It is no longer compulsory to use your pension fund to buy an annuity at age 75 to provide an income in retirement. Instead, you are allowed to use an "alternatively secured pension" (or "ASP") to pass pension assets to your family when you die,
- You will be allowed to draw a pension from any scheme if you are 50 (rising to 55 by 2010). You will not have to retire to take your pension benefits, including tax-free cash.
- The maximum death benefit will be equal to the lifetime allowance (and not 4 times salary as under current rules).

The contributions that you have made in a year are calculated as;

- Contributions to money purchase plans (including AVCs and employer contributions), **plus,**
- Annual increase in defined rights benefits (calculated as £10 for every £1 increase in pension).

You will need to calculate your total contributions each year to assess whether they are less than the lower of your annual earnings or the annual allowance (and therefore whether you will tax relief on the full amount of your contributions).

Pension funds which have a value in excess of the lifetime allowance are subject to a charge of 25% payable directly by the pension fund on your retirement. In addition, if you receive a cash lump sum on your retirement in excess of the tax-permitted amount, this excess is taxed at a rate of 40%.

The fund's value includes any defined-benefit rights, with final salary plans being regarded as having a pot worth 20 times their annual income in retirement (so, for example, a final-salary pension paying £75,000 a year will be deemed to be worth £1.5 million),

Obviously, for most people these arrangements are less restrictive than the rules previously in place.

18.17.1. High Value Pension Funds

If your pension fund is above the lifetime allowance on 6th April 2006, you can protect your benefits from the lifetime allowance tax charge by registering your fund. There are 2 options:

1. Primary protection. This increases the value of the lifetime allowance to the value of the fund on 6th April 2006. You will still pay lifetime allowance charge of 25% on any subsequent growth in value of your pension fund.

2. Enhanced protection. This offers protection from all future increases in value of your fund (and therefore from any future lifetime allowance charges, but this protection comes at a price - no further benefits can be accrued into the fund.

You have until 6 April 2009 to register your pension in this way.

TIP	If the value of your pension fund is higher than the lifetime allowance, register your fund to minimise future tax charges		
SAVE	£10,000’s	**EASE OF USE**	Complex
What you need to do	Take advice from an IFA		

18.18 Relevant Tips elsewhere in the book

- Invest in property through your pension plan (see 9.4)

19 CAPITAL GAINS

You should read this Section if you have sold valuable assets in the tax year, or if you own such assets and are thinking of selling them.

In this Section you will learn

- **Why the tax experts consider Capital Gains Tax to be a "voluntary tax"**
- **A multitude of techniques you can use to avoid paying Capital Gains Tax**

19.1 Introduction

Capital Gains Tax is a tax that is charged on the capital gain that you make when you "dispose" of an asset – an asset such as a painting, jewellery, shares or a holiday home.

In simple terms, the capital gain is the difference between an asset's sales price and its purchase cost. However, in most cases, one or more of a number of adjustments will be made to this difference to arrive at the capital gain. These adjustments are described in this Section.

Certain assets are exempt from Capital Gains Tax, including your home, your cars, shares held in an ISA (see Section 10) and chattels bought and sold for less than £6,000. Gains made on these assets are not taxed. These exceptions are explained in greater detail below.

CGT is often termed a "voluntary" tax, as some forward thinking combined with a basic knowledge of how CGT is calculated, can result in **no CGT being payable**.

Everyone is allowed to make a certain level of capital gains each year before capital gains tax is charged. This is known as the **Capital Gains Tax allowance** and it is reviewed annually in the Budget. The allowance is £8,500 for 2005/06 and is £8,800 for 2006/07.

Any gains in excess of this allowance are called "chargeable gains" and they are taxed as the "top layer" of your taxable income (**after** savings and investment income) at the income tax rates that apply to savings income (see Figure 19 below).

Figure 19: Income Tax rates for savings income

Tax rate	2005/06	2006/07
10%	Up to £2,090	Up to £2,150
20%	£2,090 to £32,400	£2,150 to £33,300
40%	Over £32,400	Over £33,300

To repeat then, chargeable gains are treated as the "**top layer" of your income**, and are therefore taxed after savings and investment income **at your highest rate of tax.** Refer back to page 2.9 to remind yourself how the various "layers" of your income are taxed, if you cannot remember.

Lets see how this works in practice;

EXAMPLE

*Terry Cook realised **capital** gains of £12,800 during 2005/06. His taxable income after personal allowances and reliefs was £30,000.*

*Terry's **chargeable** gains are £12,800 less £8,500 = £4,300. Terry's total taxable income for 2005/06 is therefore £34,300 (£30,000 plus £4,300).*

Terry's CGT payable is;

£2,400 (£32,400 less £30,000) @ 20%	=	*£480*
£1,900 (£34,300 less £32,400) @ 40%	=	*£760*
Total CGT payable in 2005/06		***£1,240***

As Terry has taxable income of £30,000, he can only earn chargeable gains of £2,400 before his gains exceed the higher rate income tax threshold (£32,400 for 2005/06). Thus, £2,400 of his gains is taxed at the basic rate of 20%, and the remainder of his gains (£1,900) is taxed at the higher rate of 40%.

CGT is payable on 31st January that follows the end of the tax year in which the asset was sold. CGT due on chargeable gains made in 2005/06 is therefore payable on 31st January 2007.

19.2 Transfer assets to your spouse….

19.2.1 …to make use of both annual CGT allowances

Transfers of assets between spouses are **not** taxable for Capital Gains Tax purposes.

You should therefore consider transferring some assets to your spouse **before** you sell them, in order to make use of their annual CGT allowance **as well as yours**. This will reduce your CGT bill.

EXAMPLE

Ben Goddard, a higher rate taxpayer, sold 3 paintings for a total capital gain of £20,000 on 1st March 2006. Ben's tax bill on this sale would be calculated as follows;

Capital Gains	*20,000*
Less: Annual CGT allowance	*(8,500)*
Chargeable Gains	*11,500*
CGT @ 40% thereon	*£4,600*

Ben could have saved tax by transferring a painting to his wife before it was sold.

Lets assume that Ben transferred a painting to his wife on 1st February 2006, and a taxable gain of £7,500 was made on the sale of this painting 1st March 2006.

This would leave;

- Ben with chargeable gains of £12,500 in 2005/06, on which he would have to pay tax of £1,600 (being 40% of £12,500 less £8,500), and

- his wife with a chargeable gain of £7,500, on which she would have to pay no tax as it is below her annual CGT allowance of £8,500.

The total tax to pay would be £1,600, compared to £4,600 if Ben kept ownership of all the paintings – a saving of £3,000.

There must be an actual (legal) transfer of the asset from one spouse to the other in order to qualify.

It has been estimated that the UK taxpayer could save a total of nearly £250 million in CGT each year by making transfers in this way.

TIP	Transfer assets between spouses to make use of both persons' annual CGT allowance		
SAVE	£1,000's	**EASE OF USE**	Simple
What you need to do	There needs to be a legal transfer of the asset, so you will need to make sure that the relevant people are advised and the necessary documentation is completed. For example, if a share is being transferred[23], the name of the new shareholder would need to be advised to the company concerned. If a house is being transferred, you would need to instruct a solicitor to advise the Land Registry and the house insurance should be taken out in the new owner's name. The bottom line is that you need to do whatever you would do if you had sold the asset to a third party.		
CONSIDER	Are you comfortable transferring the ownership of your assets to your spouse? Once he/she is the owner of the asset, he/she can do what they want with them.		

19.2.2 ….to pay tax at the lowest rate

Taxable gains are taxed as it they were the top layer of the taxpayer's income in that tax year.

Your CGT bill can therefore be reduced by transferring assets to your spouse **before** they are sold, if your spouse pays tax **at a lower rate than yourself**.

Again, let us illustrate this with an example.

EXAMPLE

Tom Pearmain earned £35,500 in 2005/06 from his job as a website designer. His wife, Constance, earned £7,500 from her part-time job as a classroom assistant. During the year, Tom sold some shares for £17,500, which he had bought two years ago for £5,000 (including costs).

Excluding the gain on the sale of shares;

(a) Tom's income subject to income tax is £30,605 (being £35,500 less his personal allowance of £4,895); and

(b) Constance's income subject to income tax is £2,605 (being £7,500 less £4,895).

The chargeable gain on the sale of the shares is £12,500 less the annual CGT allowance of £8,500, or £4,000.

If the shares were owned by Tom, £1,795 of this gain would fall within the basic rate band (being the difference between £32,400 and £30,605) and the remaining £2,205 would fall within the higher rate band. The CGT that he would pay on the sale of the shares would be £1,241.00, calculated as the total of;

£1,795 at 20%	*=*	*£359.00*
£2,205 at 40%	*=*	*£882.00*

[23] In order to transfer the ownership of a share, you will need to complete a share transfer form, which can be obtained from stockbrokers, banks, accountants or solicitors.

An Inland Revenue office must 'stamp' the form before you send it to the Company Secretary (or to the Registrar of Companies at Companies House if the shares are in a family company).

You will have to pay stamp duty, being half a percent of the market value of the shares on the date that they are transferred. In some circumstances this may involve further action by the Inland Revenue in arriving at an agreed value of the shares.

If Tom had transferred the shares to Constance before they were sold, all of the gain would fall within the basic rate band (her total taxable income would become £6,605), and therefore be taxed at 20%. The CGT payable would therefore be £880. The transfer of the shares prior to sale would save £1361 in CGT. The savings are more significant if a higher rate taxpayer can transfer assets to a non-taxpayer.

TIP	Transfer assets to the spouse that pays tax at the lowest rate		
SAVE	£100's	**EASE OF USE**	Simple
What you need to do	As with the previous Tip, this only works if there is a **legal transfer** of the asset, so you will need to make sure that the relevant people are advised and the necessary documentation is completed.		
CONSIDER	Are you comfortable transferring the ownership of your assets to your spouse? Once he/she is the owner of the asset, he/she can do what they want with them.		

19.3 Joint ownership

If you do not want to transfer the full amount of the asset to your spouse, you could always transfer **part** of the asset or put it into joint names.

If you hold an asset in joint names, the gain is apportioned between you and your spouse in the ratio of your respective interests in the asset at the time of sale.

This can achieve the same tax saving, but in a lower risk way.

ILLUSTRATION

If you are intending to sell 2 assets in the future and you expect to realise the same capital gain on each, you can achieve the same CGT saving by putting both of the assets into joint ownership as you would by transferring the ownership of one of the assets to your spouse. However, in the first instance, you remain co-owner of both assets and therefore have some control over what happens to them.

TIP	Consider joint ownership of assets if you are not comfortable transferring ownership entirely to your spouse		
SAVE	£1,000's	**EASE OF USE**	OK
What you need to do	As with the previous Tips, this only works if the legal ownership of the asset is changed to reflect "joint ownership". You will need to make sure that the relevant people are advised and the necessary documentation is completed.		

19.4 Divorce settlements

Transfers of assets between spouses are only free of capital gains tax **if** the couple are married and living together, **or if** the transfers were made in the (tax) year of separation.

When negotiating divorce or separation settlements, which will normally always involve the transfer of assets between spouses, the potential CGT bill on transfers of assets that occur **after** the year of separation will need to be taken into account.

TIP	Make sure that divorce settlements take account of any CGT that is payable on asset transfers		
SAVE	£1,000's	**EASE OF USE**	Difficult
What you need to do	You will need to take advice from your solicitor and possibly also a tax advisor to make sure that the CGT liability has been appropriately allowed for in any divorce settlement.		

19.5 Indexation allowance

"Indexation allowance" is an allowable deduction when you are calculating the gain that you have made on the sale of an asset.

Indexation allowance is a measure of the increase in the value of an asset that has been caused solely by inflation over the period that the asset has been owned.

If you make a capital gain on the sale of an asset, you can **deduct** Indexation allowance from the gain **before** calculating how much tax you have to pay. Indexation allowance basically increases the cost of the asset in line with inflation (and thereby decreases the gain that is taxable). However, **it cannot increase or create a capital loss.**

It applies only to assets that you owned between **31st March 1982** and **5th April 1998** (after which time it was replaced by "Taper Relief" – see 19.6 below).

A table of indexation rates is included as Appendix 6.

EXAMPLE

Sebastian French bought a holiday home in Devon in February 1987 for £80,000. The legal fees and stamp duty came to £1,100. Sebastian added a swimming pool to the property in February 1990 at a cost of £15,000.

Sebastian sold the house for £325,000 on 20th August 2003. Estate agent's commission and solicitors fees came to £7,900.

The indexation rate between February 1987 and April 1998 (when Indexation Allowance stopped) is 0.62 and from February 1990 to April 1998 is 0.353 (see Appendix 7).

The chargeable gain, before taper relief, is £165,423, calculated as follows;

Sale price			*325,000*
Less; Costs of sale			*(7,900)*
			317,100
Less:	*Purchase price*	*80,000*	
	Costs of purchase	*1,100*	
	Swimming pool	*15,000*	
		96,100	
Indexation allowance:			
	£81,100 x 0.62	*50,282*	
	£15,000 x 0.353	*5,295*	
			151,677
Chargeable gain before taper relief			*£165,423*

Indexation Allowance reduces Sebastian's chargeable gain by £52,577.

TIP	Claim Indexation allowance on assets owned between 31/3/82 and 5/4/98		
SAVE	£1,000's	**EASE OF USE**	OK
What you need to do	Apply the indexation rates set out in Appendix 6 to the cost of the asset, as shown in the Example above.		

19.6 Taper Relief

19.6.1. Claim Taper Relief

Taper relief replaced Indexation allowance from 5 April 1998.

Taper relief reduces the proportion of the chargeable gain that is taxed and it is applied **after deducting** any indexation allowance (see 19.5) and any capital losses arising on the sale of other assets that you choose to offset against the chargeable gain.

The amount of taper relief is governed by two factors;

- The number of **whole years** that an asset has been owned (from 6th April 1998 or the date of acquisition if later); and

- Whether the asset was a **business** or **non-business** asset.

Figure 20 below sets out the proportion of the chargeable gain that is taxable taking account of these factors.

Figure 20: Taper relief

	Whole years of ownership after 5th April 1998	Taper rate (% of gain that is chargeable)	% of gain paid in tax by a basic rate taxpayer	% of gain paid in tax by a higher rate taxpayer
Non-Business asset	Under 3	100%	20%	40%
	3	95%	19%	38%
	4	90%	18%	36%
	5	85%	17%	34%
	6	80%	16%	32%
	7	75%	15%	30%
	8	70%	14%	28%
	9	65%	13%	26%
	10 or more	60%	12%	24%
Business asset	Under 1	100%	20%	40%
	1	50%	10%	20%
	2 or more	25%	5%	10%

As Figure 20 shows, the amount of the Relief is significant, particularly for “business assets”;

- For **non-business assets** the Taper Relief reduction can be as high as 40% of the gain, so it is worth claiming (although you have to have owned an asset for 10 years to qualify for this maximum deduction)

- For **business assets**, the Taper Relief reduction can be as high as 75% of the gain (and you only have to have owned the asset for 2 years to qualify for this maximum deduction).

If you owned an asset on **17th March 1998**, when you sell it you are allowed to claim taper relief for **one year more than your actual period of ownership**.

ILLUSTRATION

If you sold a non-business asset on 15th May 2005, which you owned on 17th March 1998, you will be able to claim taper relief for 8 years of ownership (rather than 7).

EXAMPLE

Carrying on from the previous example, Sebastian owned the house for 5 complete tax years after the end of Indexation allowance (5/4/98 to 20/8/03).

As Sebastian owned the house on 17/3/98 he is allowed to claim one extra year's ownership, which means that he is entitled to claim Taper Relief based on 6 year's ownership.

Figure 19 shows that 80% of the gain is chargeable to tax if you have owned an asset for 6 years (Taper Relief therefore reduces the taxable gain by 20%).

For Sebastian, this means that the gain, after taper relief, is;

80% of £165,423, or £132,338

Deducting his annual CGT allowance of £7,900 (for 2003/04) leaves him with a chargeable (or taxable) gain of £124,438. As a higher rate taxpayer, Sebastian will pay tax at the rate of 40% on this gain, leaving him with a CGT bill of £49,775.

TIP	Claim taper relief		
SAVE	£1,000's	**EASE OF USE**	OK
What you need to do	Apply the Taper Relief proportions set out in Figure 19 to the gain, as shown in the example above, and don't forget to claim the extra year's taper relief if you owned the asset on 17th March 1998.		

19.6.2 Total period of ownership

When assets have been transferred between spouses, you can use the **aggregate** period of ownership (i.e. the time that the asset has been owned by the husband **and** wife) to determine the amount of Taper Relief.

TIP	Calculate taper relief based on the total period that an asset has been owned		
SAVE:	£1,000's	**EASE OF USE**	Child's Play

19.6.3 Business Assets

As we have seen from Figure 20, Taper Relief is much more generous on "business" assets.

Business assets are widely defined and you don't even need to own a business to have them.

They are;

- **Shares** or securities in an **unlisted company** (including companies quoted on the Alternative Investment Market (AIM)),
- **Shares** or securities in a **listed trading company** in which you can exercise **at least 5%** of the voting rights,
- **Shares** or securities in a **company that employs you**, **<u>unless</u>** it is a non-trading company **<u>and</u>** you own more than 10%,
- **Assets** which you use in your **own trading business** (sole trader, partner, or unlisted trading company where you own more than 5% of the voting rights),
- **Assets** that you use for **your work** if you are **an employee or director** of a trading company.

"Trading company" **excludes** businesses set up purely for investment or property development, although the renting of furnished holiday accommodation **<u>does</u>** count as a "trade".

When calculating taper relief, you must make sure that you classify assets as "business assets" wherever possible.

When deciding what assets to invest in, you will need to bear in mind that any asset that can be classified as a "business asset" is treated **much more favourably** for tax purposes than a non-business asset. Once a business asset has been owned for 2 years a higher rate taxpayer will only pay 10% of the gain in tax, whereas he/she will pay 40% of the gain on a non-business asset. For this reason, you should consider making "business assets" a part of your investment portfolio.

TIP	Minimise your CGT bill by investing in "business assets"		
SAVE	£1,000's	**EASE OF USE**	OK

19.6.4 Commercial property

As we have seen, one of the special rules of Capital Gains Tax is that "business assets" attract a much lower rate of Capital Gains Tax than "non-business", or personal, assets.

A good way of making use of this differential tax rate is to invest in commercial property.

If you own commercial premises, and these premises are let to a private limited trading company that is unconnected to yourself, this is treated as a Business Asset for Capital Gains Tax purposes.

If the premises are owned for at least two years, and you then sell the premises, a basic rate taxpayer will only pay 5% of any gain in tax (and a higher rate taxpayer will only pay 10% of any gain in tax).

This is a significant tax advantage compared to non-business assets, which you would have to own for 10 years to reduce your effective tax charge down to its lowest level and, at 12% for a basic rate taxpayer and 24% for a higher rate taxpayer, these levels are still significantly higher than the business asset rate.

Commercial property is a very tax-efficient investment, and can also be very profitable in times of rising property prices.

TIP	Take advantage of the lower rate of CGT that applies to "business assets" by investing in commercial property		
SAVE	£1,000's	**EASE OF USE**	OK

19.7 Capital losses

19.7.1 Realise losses to offset against chargeable gains

As we have seen, the excess of your chargeable gains over your annual CGT allowance (£8,200 for 2004/05) is chargeable to income tax at your **highest rate of tax**. Higher rate taxpayers will therefore pay tax at 40% on these gains.

You should consider whether it is worthwhile selling other assets before the end of the tax year to realise a capital loss (i.e. the amount you receive from selling the asset is **less** than the amount that you paid for it in the first place), which you can then use to reduce your chargeable gains.

EXAMPLE

Lee Brooker, a higher rate taxpayer, has made capital gains of £18,200 in 2005/06.

Lee also owns 2,500 shares in an IT company, which he bought for £5 a share in 2001, and which are quoted on the London Stock Exchange at £1 a share on 5th April 2006.

If Lee did not sell the shares on 5th April 2006, he would have to pay CGT of £3,880, calculated as follows;

Capital gains	*18,200*
Less: Annual CGT exemption	*(8,500)*
Taxable gain	*9,700*
Tax at 40%	*3,880*

If Lee sold his shares on 5th April 2005, he would realise a loss of £10,000, which would eliminate his tax charge for 2005/06, saving him £3,880. Lee could always buy back the shares at a later date, if he thought that they were going to increase in value.

TIP	Reduce your tax bill by selling assets on which you can claim a capital loss		
SAVE	£1,000's	**EASE OF USE**	Simple
CONSIDER	If you are interested in "buying back" the assets shortly after you have sold them, be aware of the rules on "bed and breakfasting" (see 19.20 below)		

19.7.2 Always report your capital losses

If you make a capital loss on the disposal of assets during the year (because you have sold them for less than you paid for them), make sure that you **report the losses on your Tax Return**.

It is all too easy to forget to report capital losses in periods when you have not had any chargeable gains, as they have **no effect** on the tax that you pay in the tax year. But don't forget, as these losses are valuable. They can be carried forward and offset against any capital gains that you make in future tax years, which will **reduce your future tax bills**.

If you do not advise the Revenue of your losses when you make them, you run the risk of not being able to offset them against future capital gains.

TIP	Report all capital losses, even if you do not have capital gains		
SAVE	£1,000's	**EASE OF USE**	Simple
What you need to do	Fill in Lines 13 to 16 of the "Capital Gains" Supplementary Pages of your Tax Return for the disposal that gives rise to the loss.		

19.7.3 Keep a record of your capital losses

You will need to **keep records** of the capital losses that you have reported on your Tax Return, so that you can remember to bring them into future year's tax calculations.

TIP	Keep a record of the capital losses that you have reported on your Tax Return and update it, year by year.		
SAVE	£1,000's	**EASE OF USE**	Simple
What you need to do	Keep a tax file and have a page within it that keeps track of your capital losses		

19.7.4 Claim a capital loss where an asset has not been sold

You do not have to **dispose** of an asset to claim a capital loss – you can also claim a loss where an asset becomes of **negligible or nil value**.

You have a **two-year period** from the end of the tax year in which the asset become of nil or negligible value to make a claim for a loss in these circumstances.

TIP	Claim a capital loss for assets that have lost their value		
SAVE	£1,000's	**EASE OF USE**	Simple

What you need to do	At the end of the tax year, review all of your assets to see whether any have lost their value. Concentrate particularly on shares. Fill in Lines 13 to 16 of the "Capital Gains" Supplementary Pages of your Tax Return for any assets that have lost their value.

19.7.5 Offsetting a capital loss against other taxable income

If you make a capital loss on an investment in an **unquoted company** then, as long as long as you acquired the shares by subscription and not by transfer from an existing shareholder, you can elect to set the loss against **any other taxable income** of the **current or previous tax year**. This is the **only time** when you are allowed to offset a **capital** loss against your **other taxable income.**

For shares issued **after** 5th April 1998, this relief is only available where the company would be a qualifying company for the purposes of the Enterprise Investments Scheme provisions. In broad terms this means that the company has to have gross assets of less than £15 million and be;

- Unquoted, and
- Carrying on a qualifying trade in the UK (which excludes, among other things, property development, legal services and financial services)

This relief can be especially useful for people who make an unsuccessful investment in their own family company.

Also, if you have lent money to a company and the company cannot afford to repay you, you should ask the company to issue you with new shares in substitution for this loan. Your loan will no longer be repayable but, if the company eventually folds, you will get a tax deduction for your investment at your highest rate of tax (which you would not get if you kept your loan).

Claims must be made within one year of the 31st January after the end of the tax year in which the loss was made (i.e. 31st January 2006 if the loss was made in 2004/05). Claims are made by filling in the appropriate boxes on your Tax Return (see the Tip box below).

TIP	Reduce your taxable income by making a claim under Sections 574-576 of the Taxes Act 1988		
SAVE	£1,000's	**EASE OF USE**	Difficult
What you need to do	Give details of the loss on pages CG2 and CG3 and then put the loss that you are claiming in Box 8.13A or 8.14A of the Capital Gains Tax pages of your Tax Return.		

19.8 Sell assets to use up your annual allowance

If you do not use all of your annual tax-free allowance in one year, you **cannot carry it forward**. It is lost.

It is worth considering selling assets each year to generate gains that will use up your annual tax-free allowance, as all of these gains will be tax-free.

You will pay much less CGT if you have a policy of regularly selling assets and realising small gains, rather than holding on to assets over a long period and realising large gains infrequently.

However, you will need to bear in mind the rules on "bed and breakfasting" – see 19.20 below - which restrict your ability to re-purchase the same asset soon after selling it.

TIP	Sell assets each year to use up your annual tax-free allowance		
SAVE	£1,000's	**EASE OF USE**	Simple
CONSIDER	The rules on "bed and breakfasting"		

19.9 Claim allowances in the right order!

We have talked about a number of potential deductions that reduce a capital gain before it is taxed, including indexation allowance, capital losses, taper relief and the annual CGT allowance.

These deductions must be handled in the correct order. The flowchart overleaf explains this order.

You will see from this that you must use capital losses before Taper Relief. In some instances it will be worthwhile not claiming a deduction for capital losses and, instead, using the Taper Relief on an asset to reduce the tax charge.

EXAMPLE

Andrew Granger is a partner in a solicitors' practice. Andrew realised capital losses of £15,000 in 2005/06 on the sale of certain "hi tech" shares.

Andrew owned the office that the practice had been based in since it began 5 years ago.

In June 2005, Andrew sold the office and made a capital gain of £30,000 on its sale. As the gain relates to a business asset that has been owned for at least 2 years, this gain qualifies for 75% Taper Relief (refer to Figure 20 in 19.6).

If Andrew offsets his capital losses against this chargeable gain, his taxable income would be;

Capital gain	*30,000*
Less: Capital losses	*(15,000)*
	15,000
Less: Taper relief (75%)	*(11,250)*
Chargeable gain	*3,750*

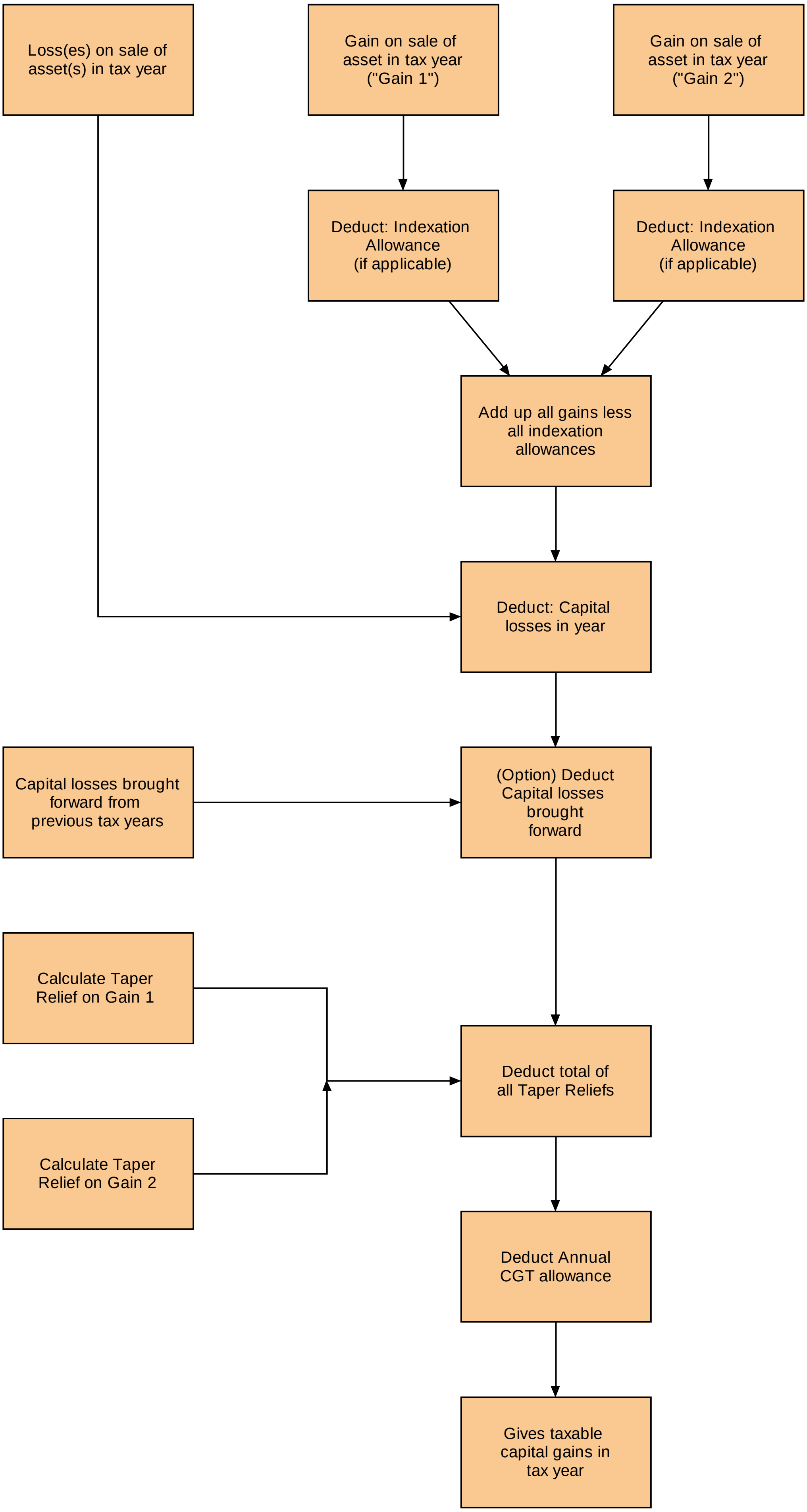
As Andrew has an annual Capital Gains Tax allowance of £8,500 for 2005/06, he will not pay any tax.

Alternatively, if Andrew carried his capital losses forward (and did not offset them against his capital gain), his taxable income would be calculated as follows;

Capital Gain	*30,000*
Less: Taper relief (75%)	*(22,500)*
Chargeable gain	*7,500*

*Given that Andrew has an annual CGT allowance of £8,500, he will still not pay any tax **and** he would carry forward his capital losses to offset against future capital gains.*

TIP	Make capital gain deductions in the right order!		
SAVE	£1,000's	**EASE OF USE**	OK
What you need to do	Follow the flowchart overleaf		
CONSIDER	Not claiming a deduction for capital losses brought forward and claiming Taper Relief instead.		


Loss(es) on sale of asset(s) in tax year
Gain on sale of asset in tax year ("Gain 1")
Gain on sale of asset in tax year ("Gain 2")
Deduct: Indexation Allowance (if applicable)
Deduct: Indexation Allowance (if applicable)
Add up all gains less all indexation allowances
Deduct: Capital losses in year
Capital losses brought forward from previous tax years
(Option) Deduct Capital losses brought forward
Calculate Taper Relief on Gain 1
Calculate Taper Relief on Gain 2
Deduct total of all Taper Reliefs
Deduct Annual CGT allowance
Gives taxable capital gains in tax year

19.10 Disposal Timing

19.10.1 Spread disposals over more than one tax year

You should plan the disposal of valuable assets so that you maximise the use of your annual capital gains tax allowance.

For example, look to dispose of valuables over two or more years, rather than all in one go. Not only will your total chargeable gain be lower (as you will be deducting more than one year's annual CGT allowance), but you will pay tax later.

EXAMPLE

Ben Goddard, a higher rate taxpayer, sold 3 paintings for a total taxable gain of £20,300 on 1st March 2006. Ben's tax bill on this sale is £4,680 (being 40% of £12,100), payable on 31st January 2007.

If Ben had sold only one painting for a capital gain of £7,000 on 1st March 2006 and the remaining two paintings for a capital gain of £13,000 on 10th April 2006, his taxable gains would be;

2005/06:

Capital gain	*7,000*
Annual CGT allowance	*(8,500)*
Taxable gain	*0*

2006/07:

Capital gain	*13,000*
Annual CGT allowance	*(8,800)*
Taxable gain	*4,200*

His total tax bill would be a much-reduced £1,680 (being 40% of £4,200), payable on 31st January 2008.

EFFECT: A saving of £3,000 in tax and the tax is payable 12 months later.

TIP	Spread the disposal of assets over more than one tax year to maximise the use of CGT allowances		
SAVE	£1,000's	**EASE OF USE**	Simple

TIP	Defer the disposal of assets to the next tax year to get an extra 12 months to pay the tax		
BENEFIT	£1,000's	**EASE OF USE**	Simple

19.10.2 Delay a disposal to get extra Taper Relief

As we have already seen, Taper Relief is given based on **the number of complete years that an asset has been owned**.

If you are considering selling an asset and it is close to the time of year when you bought the asset in the first place, it may be worthwhile **delaying the sale** to claim an extra year's Taper Relief.

For non-business assets, this delay could reduce the tax on the gain by 2% for a higher rate taxpayer and 1% for a basic rate taxpayer. These are not large percentages but, if you are talking about a profit of £100,000 on the sale of a house, 2% equals £2,000.

For business assets, this delay could potentially reduce the gain by as much as 20% for a higher rate taxpayer (saving you £20,000 on a £100,000 gain) and 10% for a basic rate taxpayer.

TIP	Consider delaying the sale of an asset to get an extra year's Taper Relief deduction		
SAVE	£1,000's	**EASE OF USE**	Simple
CONSIDER	What is the risk of the value of the asset falling in the meantime?		

19.11 Keep documentation

You should make sure that you keep the documentation to support the dates and costs of **buying, maintaining and selling** any assets that you own that are potentially subject to CGT.

This documentation will be needed to support your CGT calculations when the assets are sold. Without it, you will not be able to minimise the tax that you are required to pay.

TIP	Keep documents that provide evidence of asset costs		
SAVE	£100's	**EASE OF USE**	Child's Play

19.12 Advice from the Revenue

The Inland Revenue offer a free asset valuation service to help you complete the Capital Gains pages of your Return.

All you need to do is ask for a Form CG34 for each valuation that you require and then submit the completed Form back to your Tax Office along with any other information requested on the Form.

TIP	Get the Revenue to provide you with a valuation of an asset if you cannot find the documentation to prove the cost or value of an asset

19.13 Penalties

You will need to fill in the supplementary Capital Gains pages of your 2005/06 Tax Return if, during the tax year;

- You sold your home and the gain that you made is not completely tax-free (see 19.16 below), **or**
- You disposed of assets that were subject to Capital Gains Tax and were worth more than £34,000, **or**
- Your taxable gains amount to more than £8,500 after taper relief, **or**
- Your taxable gains amount to more than £8,500 before taper relief **and** you have capital losses, **or**
- You have some other claim or election (for example, you have made an overall loss)

If you do not complete these pages you will be liable to pay unnecessary penalties.

The disposals limit has been set at four times the capital gains tax allowance, so for 2006/07 the reporting threshold is £35,200 and not £34,000.

TIP	Fill in the Capital Gains pages of the Tax Return if you meet any of the above criteria		
SAVE	£100	**EASE OF USE**	OK

19.14 Chattels

Chattels are defined as "tangible movable property", or more commonly "personal goods and effects". Chattels include works of art, paintings, antiques, jewellery, furniture, stamps and ornaments.

Capital gains that you make from the sale of Chattels are **not taxable** if the item is sold for **less than £6,000**. You do not have to report such gains on your Tax Return. This limit applies to each item that you sell – it is not an annual limit.

The downside to this is that you cannot claim a capital loss on a chattel that is sold for less than £6,000.

TIP	Do not report gains on chattels sold for less than £6,000		
SAVE	£1,000's	**EASE OF USE**	Simple

If chattels are sold for **more than £6,000**, the **gain <u>is</u> taxable**.

However, the gain is restricted to 5/3 of the amount by which the sale proceeds exceed £6,000.

ILLUSTRATION

If a painting was sold for £6,900, realising a gain of £2,500, the taxable gain would be restricted to £1,500;

£6,900 – £6,000 = £900
£900 x 5/3 = £1,500

If the same painting was sold for £9,000, realising a gain of £4,600, the taxable gain would not be restricted;

£9,000 - £6,000 = £3,000
£3,000 x 5/3 = £5,000

As £5,000 is higher than the actual gain, the actual gain is taxed.

TIP	Restrict the gain that you report on chattels sold for just over £6,000		
SAVE	£1,000's	**EASE OF USE**	OK

19.15 Wasting Assets

"Wasting Assets" are defined as assets with a predicted **life of less than 50 years** and which are not owned by a business. Wasting Assets include machinery, which means that antique clocks and classic cars, for example, are exempt from CGT. As such, they are attractive investments (in tax terms, at least).

Capital Gains that you make from the sale of Wasting Assets are **not taxable**. You do not have to report thgese gains on your Tax Return.

TIP	Do not report gains on wasting assets		
SAVE	£1,000's	**EASE OF USE**	Simple

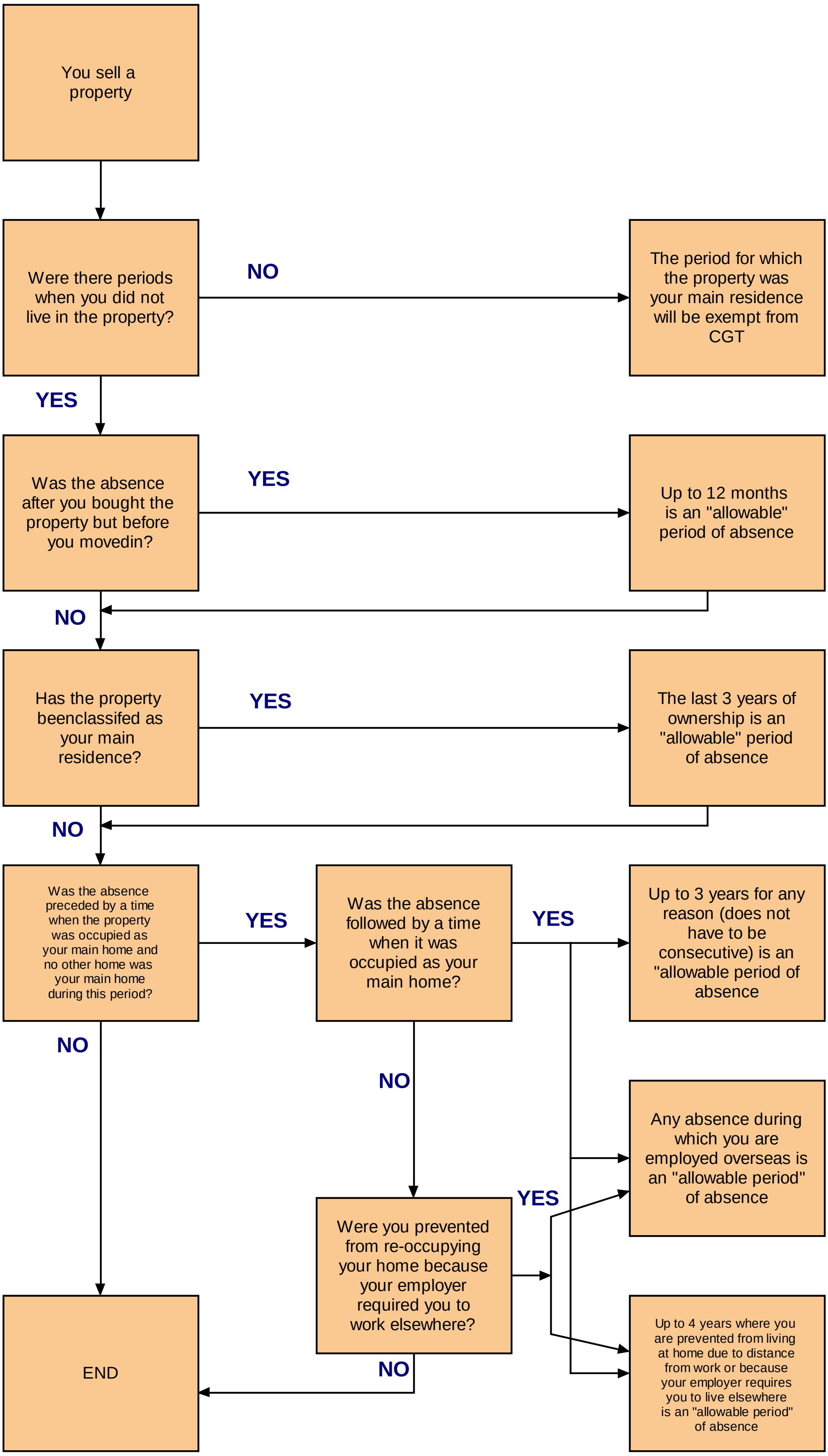
19.16 Your Home

19.16.1 Allowable periods of absence

Any gain that you make on the sale of your "main residence" (see 19.16.2 for definition) is exempt from Capital Gains Tax, **unless** you have;

- used part of the home for **business purposes,** or
- **rented out** part of the home, or

- had “periods of absence” when you have **not lived in the property** and these periods are not “allowable”. Allowable periods of absence are illustrated by the flowchart below



Any time away from your home that does not fall into these "allowed" periods of absence, will cause a CGT liability to be triggered when you sell your home.

Wherever possible, therefore, you should try to ensure that any period when you are not living at home is an "allowable period of absence", as defined above, as this will ensure that you minimise your CGT bill when you sell your home.

TIP	Be aware of the rules and, if you need to spend time away from your "main residence", try to ensure that you maximise your allowable periods of absence		
SAVE	£1,000's	**EASE OF USE**	OK

19.16.2 If you own two or more homes

If you own more than one home, you have to elect which one to treat as your "**main residence**" for CGT purposes.

The property chosen **need not actually be your main home**, although it cannot be an investment property.

The election is important because, generally speaking, you will be liable to pay CGT on any gain that relates to a period when a property was **not** your "main residence".

This election is done by your writing to your local Tax Office, stating the details of the house that is to be treated as your main residence and the date from which the election is effective.

You can change the election as often you want, so your "main residence" can be varied as and when it suits you.

The time limit for making an election to the Inland Revenue is two years from the date on which you begin to own two homes (or a new property is acquired), although this may be extended by Revenue concession in some cases. This means that you can effectively backdate your election up to 2 years.

If you do not make an election, the Inland Revenue may decide as a question of fact which property is your main home (by looking at the time that you spend in each property).

Husband and wife living together can have only one "main residence" between them. There is no scope for tax planning here.

However, there are four opportunities to reduce CGT.

- Elect for each of your houses to be your main residence for some period,
- Elect your "main residence" to be the house on which you expect to make the biggest chargeable gain,
- Jointly own houses to use up both spouses annual CGT allowance,
- Allocate part of the sales price to chattels

Lets look at each in turn.

1. Elect for each house to be your main residence for some time

Provided that a house has, **at some time**, been your main residence, **the last 36 months of ownership are always ignored when computing any capital gain** (as this is one of the "allowable periods of absence mentioned previously in 19.16.1 above).

It is therefore very worthwhile electing for **each of the houses** that you own to be your main residence for a period of a week. This will ensure that all of your houses qualify for this 36-month exemption.

TIP	Elect for each house that you own to be your "main residence" for a short period		
SAVE	£1,000's	**EASE OF USE**	OK
What you need to do	Write to your Tax Office, as described above		

And remember, you are allowed to change the house that is your main residence by writing to the Inland Revenue and this change is effective for a period of up to **2 years prior to that notification**.

You can use this to your advantage.

For example, if you have owned two houses for a number of years, and you then sell the property that is not your "main residence" at a gain, you can make an election just after the sale of the house that will reduce your taxable gain.

EXAMPLE

Margaret Cooke has owned houses at Hill Rise (House 1) and Church Walk (House 2) for many years. She has previously made an election to treat House 1 as her main residence. On 1 November 2004, she sold House 2 and made a large gain.

On 1 December 2004, she submits an election to the Revenue to treat House 2 as her main residence from 1 December 2002 (as this election is effective for 2 years prior to the election date).

One week later on 8 December 2004, Margaret notifies the Revenue that she nominates House 1 as her main residence from 8 December 2002.

The elections mean that House 2 was Margaret's main residence for 1 week during 2002.

Hence she is entitled to claim an exemption from Capital Gains Tax for any gain made during the last three years' ownership of House (see "allowable periods of absence" above), at the expense of lost relief of one week in respect of House 1.

This means that any gain made during the last 23 months of her ownership of House 2 is not taxable.

This is a simple way of saving a lot of tax during times of rapidly escalating house prices.

TIP	Use the "main residence" exemption to your advantage when you sell a property that is not your "main residence".		
SAVE	£1,000's	**EASE OF USE**	OK
What you need to do	As soon as you consider selling a property that is **not** your main residence for tax purposes, calculate the Capital Gains tax that you will have to pay and, if necessary, plan actions to reduce this by, for example, making a retrospective "main residence" election as described above.		

2. Elect for your main residence to be the house on which you expect to make the biggest chargeable gain

The house on which you are likely to incur the **biggest chargeable gain** should be your "main residence", **for as long as possible, <u>irrespective</u>** of your actual living arrangements.

You will need to elect for other properties to be your main residence for the odd week here and there to take advantage of the previous Tip but, generally speaking, the house on which you expect to make the largest chargeable gain should be your main residence for the longest period possible.

The factors that you therefore need to take into account when making your choice include;

- the properties’ current values (a higher value house will generate a larger gain than a lower value house, if property price inflation is the same for both properties),

- the time that you expect to own the properties. There is no point electing for a house to be your main residence if you have no intention of selling it,

- house price inflation.

TIP	Maximise the period of “main residence” for the house on which you will incur the greatest capital gain		
SAVE	£1,000’s	**EASE OF USE**	OK
CONSIDER	You will need to look at all of your properties on a regular basis and compare them, to see which has generated the largest taxable gain. You will also need to bear in mind how long you intend to hold on to the properties and assess whether the gains that have been made to date are likely to be indicative of future gains. You will need to remain flexible, as you may need to change your “main residence” election if the relative values of your properties’ change.		

3. Jointly own houses to use up both spouses annual CGT allowance

Spouses should consider **joint ownership** of any houses that are not their “main residence”. This will enable **each** spouse to make use of their annual CGT allowance when these houses are sold, making the first £17,600 of any gain (in 2006/07) tax-free.

TIP	Become joint owners of properties that are not your main residence		
SAVE	£1,000’s	**EASE OF USE**	OK
What you need to do	Joint ownership under either a “joint tenancy” or a “tenants in common” arrangement will enable any capital gain to be split between the two owners. Speak to a solicitor to arrange for properties to be put into joint ownership.		

4. Allocate part of the sales price to Chattels

If you are selling a house that is not your “main residence” for Capital Gains Tax purposes, you should ask your solicitor to allocate part of the selling price to its “wasting chattels”, namely the garden shed and other fixtures and fittings.

As we have said previously (see paragraph 9.1, Stamp Duty Land Tax, above), it is generally acceptable to allocate between 5% and 10% of the purchase price of the house to chattels

Your gain for Capital Gains Tax purposes will be calculated using the sales price **excluding** the value of these items.

TIP	Allocate part of the sales price to chattels to reduce your taxable gain on a house that is not your main residence.		
SAVE	£1,000’s	**EASE OF USE**	Simple
What you need to do	The buyer of your property will also be motivated to maximise the value attributed to chattels, as this will reduce the stamp duty that the buyer will pay. Agree between you (with the consent of your solicitors) a value for chattels which is within the 5% to 10% guideline generally applied by the Inland Revenue.		

19.16.3 Sell your garden first

If you are looking to sell your house and garden (or part of the garden) separately, you should sell the garden first.

In this way, the sale of the garden and the house will be tax-free. If you sold the house first, the subsequent sale of the garden would be taxable.

TIP	If you are selling land and property separately, sell the land first		
SAVE	£1,000's	**EASE OF USE**	Simple

19.17 Lettings exemption

If you let all or part of your home, you may have to pay capital gains tax on part of the capital gain that you make when you later dispose of that home.

The rules are that;

- You get **full exemption** from CGT for that part of the gain that relates to the period when the house was your "main residence" and was not let (as described in 19.16 above);
- You get "**lettings exemption**" for the period when the house, or part of it, was let, which is calculated as the **lower of**;
    - **£40,000**; or
    - the **"exempt" gain** that relates to the **period when you occupied the house as your "main residence"**.

The lettings exemption is only available if the letting relates to all or part of a property that is, or was, your main home. A self-contained flat is specifically excluded from this exemption, as such flats are not considered to be "part of the home".

EXAMPLE

Martin Tombs made a capital gain of £120,000 when he sold his home in December 1998.

Martin bought his home in January 1993, and he had lived in it for the entire period, apart from a period of 27 months from 1 July 1993 to 30 September 1995, when he was working in the USA. During this period, the house was let and the house was not regarded as Martin's main residence. The period of ownership was therefore 71 months and the house was Martin's main residence for 44 months.

Capital Gain	*120,000*
Less; Main residence exemption (44 months)	
120,000 x 44/71	*(74,366)*
Less; Lettings exemption	
(lower of £40,000 or £74,366)	*(40,000)*
Chargeable gain[24]	*5,634*

The gain would have been £40,000 higher without the lettings exemption.

The lettings exemption does not apply if you are renting out part of your home to lodgers or to take advantage of the "Rent A Room" scheme – see 9.3.10 below.

[24] Excluding taper relief

TIP	Claim lettings exemption to reduce your taxable gain		
SAVE	£1,000's	**EASE OF USE**	OK
What you need to do	Fill in Column G of pages CG2 and CG3 of the Capital Gains tax pages of your Tax Return		

19.18 Lodgers

You do not lose **any** of your "main residence" exemption from capital gains tax for any period when;

- You **take in lodgers or boarders** who mix in and eat with your family; or
- You **take advantage of the "rent a room" scheme** discussed in 9.3.10.

TIP	Rent out part of your home without losing your "main residence" exemption from CGT		
SAVE	£1,000's	**EASE OF USE**	OK

19.19 Individual Savings Accounts (ISAs)

Capital gains arising from assets **within** an ISA are exempt from CGT. Given this, it really does not make any sense to hold investments outside an ISA. If you have not read 10.1 on ISAs, you might want to read it now.

If you own investments that are not within an ISA, and you have not used up all of your annual ISA investment allowance (£7,000 in 04/05 and 05/06), you should use any "surplus" allowance by transferring investments of that value into an ISA. This procedure is explained in 10.1.6.

TIP	Invest in stocks and shares via a Maxi ISA (see 10.1) and pay no CGT on gains.		
SAVE	£1,000's	**EASE OF USE**	OK
What you need to do	Refer to 10.1 which explains how you invest in ISAs		

19.20 "Bed and Breakfasting"

In the past, a technique called "bed and breakfasting" was used to reduce Capital Gains Tax on the sale of assets, which were usually shares.

This practice involved the sale of shares just before the end of a tax year, to crystallise a capital gain that was less than the annual capital gains allowance, and their **immediate re-purchase early in the new tax year.** The practice was useful, as it meant that the value of your investments could effectively grow without you having to pay CGT.

"Bed and breakfasting" is now forbidden; if a period of **30 days** does not elapse between the sale of an asset and its re-purchase, you are treated for CGT purposes as if you **never sold the asset** in the first place.

However, there are two alternatives to this technique that are still permitted. They are described in 19.20.1 and 19.20.2 below.

19.20.1 Get your spouse to re-purchase the asset that you sell

The first alternative to "bed and breakfasting" is for you to sell your asset and for **your spouse** to re-purchase them the following day.

If necessary, your spouse could then transfer them back to you after the 30-day period has elapsed. This procedure has the same effect as "bed and breakfasting".

TIP	At the end of the tax year, consider selling assets to realise a capital gain or gains that are less than your annual CGT allowance (£8,800 in 2006/07) and then getting your spouse to re-purchase them immediately.		
SAVE	£1,000's	**EASE OF USE**	OK
CONSIDER	Other capital gains or losses that you have made in the year will decrease or increase the value of gains that you can make at the end of the year before you exceed your annual CGT allowance. Take these into account in your calculations.		

19.20.2 Buy a similar investment to the one that you sell

The second alternative to "bed and breakfasting" is for you to **sell your asset** and then immediately purchase **another**, **similar**, asset.

ILLUSTRATION

If you own units in an Index-Tracker Fund, you could sell them at the end of the tax year and re-invest on the same day in an Index-Tracker Fund provided by another company. There are many Index-Tracker Funds on the market and their actual composition (in terms of shareholdings) is likely to be virtually identical. As a result, the value of your new investment will probably change in the same way that the value of your old investment would have changed, had you kept it.

This method works well where you can replace on a **like-for-like basis**.

However, **don't blindly use it** where you cannot replace like-with-like, for example where you have an investment in an individual company. Even if you re-invest in a company in the same type of business, your new investment will carry a different set of risks and its value will probably change in a different way compared to that of your old investment.

In these situations, you might want to take advice from an IFA.

TIP	Sell an investment at the end of the tax year to realise a gain to use up your annual CGT allowance, and immediately purchase another, similar, investment		
SAVE	£1,000's	**EASE OF USE**	OK
CONSIDER	If you do not replace like-for-like, your new investment will carry a different set of risks, and its value will move differently compared to your old investment.		
What you need to do	If you cannot replace like-for-like, take advice from an IFA about a suitable replacement investment, and understand the different risks associated with it.		

19.21 Invest for growth

If you do not use your annual CGT allowance, you should consider putting your money into investments that will provide you with capital gains, rather than income, as this may provide you with more money after you have paid tax.

Refer back to 2.2 if you cannot remember the difference between capital gains and income.

EXAMPLE

Sam McPherson, a higher rate taxpayer, was left £20,000 in his grandfather's will in 2004 and he invested the money equally into two Unit Trusts - a High Income Unit Trust and a Growth Unit Trust.

Sam sold the units a year later in 2005.

Over the year, both Trusts produced the same overall return of 7.5%, the High Income Unit Trust producing income of 6% and capital growth (increase in unit price) of 1.5%, and the Growth Unit Trust producing income of 1.5% and capital growth of 6%.

*Sam's income from the **High Income Trust** was therefore £1,200, on which he paid tax at 40%, giving him an after-tax income of £720. Sam's gain on the sale of his High Income units was £300, which was tax-free as he offset it against his annual capital gains tax allowance. He therefore paid £480 tax and received £1,020.*

*Sam's income from the **Growth Trust** was £300, on which he paid tax at 40%, giving him an after-tax income of £180. Sam's gain on the sale of his Growth units was £1,200, which was tax-free as he offset it against his annual capital gains tax allowance. He therefore paid £120 in tax and received £1,380.*

Sam's investment in the Growth Unit Trust therefore provided him with £360 more in his pocket than the High Income Unit Trust over the year, even though they both produced the same gross return of 7.5%.

This is because Sam paid less tax on the investment that produced the high capital gain.

TIP	Pay less tax by investing for capital growth and using up your annual CGT allowance		
SAVE	£1,000's	**EASE OF USE**	OK
What you need to do	Talk to your IFA about high growth investments		

19.22 Investments that produce tax-free capital gains

We have already talked about ISAs (see 19.19), chattels (19.14), wasting assets (19.15) and pensions (18.1) as being assets that are "exempt" from capital gains tax.

By "exempt", we mean that you do not pay tax on **any gains** that you make on the disposal of these assets.

Here are some other assets that will provide you with **tax-free capital gains**;

- National Savings Certificates,
- British Government Stock ("gilts") and most company bonds,
- Life insurance policies,
- Shares in a Venture Capital Trust or an Enterprise Investment Scheme.

These investments are **particularly attractive** to people who regularly use up their annual CGT allowance by selling other assets (such as shares), as investing in assets such as those listed above ensures that they can earn a higher level of capital gains tax-free.

TIP	Consider investing in assets that generate tax-free capital gains		
SAVE	£1,000's	**EASE OF USE**	OK

In addition, you do not pay CGT if you receive the following;

- **Premium Bond prizes** and **betting, lottery or pools winnings,**
- **Cashbacks** received as an inducement to buy something,
- **Compensation** for **personal injury,**
- **Compensation for loss or damage** (e.g. from an insurance claim).

TIP	Don't report prizes, compensation or cashbacks as capital gains		
SAVE	£1,000's	**EASE OF USE**	Child's Play

19.23 Reduce your taxable income

If you know that you are going to realise a large **capital gain** in the future, it is worthwhile considering if you can reduce your other taxable income in the tax year that the sale will be made.

Taxable gains, as we have explained above, are taxed as if they are your **highest layer of income**. If you can reduce your other taxable income in the year of sale so that some, or all, of a gain is taxed at 20% rather than 40%, you will save 20% in tax.

Possible ways of reducing your taxable income include;

- Making a **one-off pension contribution,**
- Investing in assets that will generate high capital growth, but **low income,**
- **Deferring the receipt of bonuses,**
- (If self-employed) **Reducing** your **business profits** (see 8.4.2).

EXAMPLE

Callum Millard sold a holiday home in October 2005, making a gain of £20,600 on the sale. Callum's other taxable income, after allowances and reliefs, is £33,000. This includes £15,000 of income from his investments in various High Income Unit Trusts.

The chargeable gain on the sale of the holiday home is £12,100 (£20,600 less the CGT allowance £8,500 for 2005/06), which will be taxed at 40% as Callum is a higher rate taxpayer. Callum will therefore pay £4,840 in tax on the sale of his holiday home.

Let us assume that Callum could have changed his investments from High Income Unit Trusts to High Growth Unit Trusts in the previous tax year and earned the same overall return on the investments, but that this return would have comprised of a higher capital growth (by £10,000) and a lower investment income (by £10,000).

Under this scenario, Callum's tax position would be slightly different in 2005/06; his chargeable gain would be the same, but now his taxable income excluding the gain is only £23,000.

As a result, £9,400 of the gain will be taxed at the lower tax rate of 20% (being the difference between £23,000 and the higher rate band threshold of £32,400) and only £2,700 of the gain is taxed at the higher rate – giving a total tax charge on the sale of his holiday home of £2,960.

The increased gain that he has made on his investments will not be taxed until they are sold, so Callum saves £1,880 in tax even though the overall amount that he has "earned" in the tax year (being the total of income and gains) is the same.

TIP	Reduce your taxable income so that capital gains are taxed at 20% instead of 40%		
SAVE	£1,000's	**EASE OF USE**	OK
CONSIDER	Whilst it will not be practical for everyone to reduce their taxable income to save tax, it is worth considering if you have some savings that you are willing to draw upon, or if the gain is made early in the tax year (and you therefore have the proceeds from the sale to use to meet the costs of your normal standard of living).		

19.24 Defer Capital Gains Tax

You can **defer the payment** of **a CGT bill** by reinvesting the **taxable gain** in an **Enterprise Investment Scheme**. Enterprise Investment Schemes are explained in 10.10.

By reinvesting a gain in this way, the taxation of the original gain is deferred until such time as you **sell your investment in the EIS**.

It is important to recognise that you only have to re-invest an amount **equal to the gain** itself, and <u>**not**</u> the entire sale proceeds that gave rise to the gain.

In order to qualify for this "deferral relief", the gain must be reinvested within the period beginning one year before, and ending three years after, the disposal that gave rise to the gain.

You can invest any amount you like in an EIS in order to defer a CGT bill, but you can only get **income tax relief** on an investment of up to £200,000 (see 10.10).

On the negative side, EIS investments are high risk, and you may not get your money back!

Whether you opt to reinvest a gain in an EIS will depend upon several factors, including;

- your existing **financial position,**
- your attitude to **risk** (some people are naturally very careful with their money whereas others don't mind taking the odd "punt"), and
- your **existing investments** (you may already have some "risky" investments and you do not want to increase your risk any further).

The legislation dealing with investments in EISs is lengthy and complex. It contains a number of conditions and restrictions and it is an area where you would be best advised to take specialist tax advice before taking the plunge!

TIP	Defer a CGT bill by investing in an EIS		
BENEFIT	£1,000's	**EASE OF USE**	Complex
What you need to do	Take advice from a specialist before doing anything		

19.25 Increase the cost of your assets

If you have not made any capital gains taxable disposals since **5 April 1988**, you should consider making a "31 March 1982" election.

The election basically changes the "cost" that is used to calculate your taxable gains from;

- **original cost**, to
- **market value on 31 March 1982**.

Therefore, you should only make this election if the **total market value** of your assets on 31 March 1982 was higher than their **total cost**.

By making the election, the "cost" of your assets for CGT purposes will be increased and your taxable gain when you sell the assets will be smaller.

The election applies to **all** of the assets that you owned on 31 March 1982. It cannot be made for individual assets.

In order to make this election, you will need to be able to produce some form of independent valuation of your assets on or around March 31, 1982.

TIP	Increase the "cost" of your assets and reduce future CGT bills by making a "31 March 1982" election		
SAVE	£1,000's	**EASE OF USE**	OK
What you need to do	Get documentary evidence to support the market value of your asset(s) on 31 March 1982. Confirm that the total market value(s) is more than the total original cost(s). Write to your local Tax Office stating that you wish to make a "31 March 1982" election. List the assets concerned and their market values on that date. Include the documentary evidence with the letter.		

19.26 While you are overseas…..

19.26.1 ….save CGT by selling UK assets

You will not pay capital gains tax on a gain arising on the sale of a UK asset whilst you are overseas **if** you make the disposal during a period of **five consecutive tax years** when you are **neither resident nor ordinarily resident** in the UK.

The important part of this exemption is the requirement for the five-year period to comprise of **consecutive tax years**.

ILLUSTRATION

If you became non-resident in the UK on 24th August 1998, you would have to be non-resident up until at least 6th April 2004 in order to be exempt from paying CGT on disposals made during this period.

*If you become resident before this five-year period is up, **any gains** you make during your absence, on assets held prior to your departure, are taxed **immediately** when residence resumes.*

TIP	Save yourself CGT by selling assets whilst you are non resident		
SAVE	£1,000's	**EASE OF USE**	Simple
What you need to do	Stay non-resident for at least 5 consecutive tax years		
CONSIDER	The tax that you will have to pay in your country of residence		

19.26.2 ….avoid CGT in respect of assets bought and sold while you are overseas

Gains that you make on assets that you have **bought and sold** whilst you have been non-resident are not liable to CGT in the UK, no matter how long you remain non-resident.

TIP	Make tax-free capital gains in the UK whilst you are non-resident		
SAVE	£1,000's	**EASE OF USE**	Simple
CONSIDER	The tax that you will have to pay in your country of residence		

20 INHERITANCE TAX

IMPORTANT: NO MATTER WHAT YOU THINK, READ THIS INTRODUCTION.

The mistake that most people make is to think that Inheritance Tax (IHT) is only something that affects the very rich and that it therefore does not apply to them.

This used to be true, but it is not the case any more.

A Consumer's Association survey in 2003 showed that the number of people being caught by IHT had risen by more than 50% in 5 years.

Current estimates are that around 10% of families in the UK are currently "exposed" to a potential Inheritance Tax liability, as they own assets worth more than the current Inheritance Tax threshold (£285,000).

The continued explosion in house prices in the UK will mean that more and more people will be liable to pay Inheritance Tax in the future.

Don't assume that it won't apply to you.

Read the introduction to this Section and decide whether you need to take steps to reduce your potential IHT bill.

In this Section, you will learn

- **How Inheritance Tax is calculated and whether it will affect your family. About 25% of you are going to be in for a very unpleasant surprise!**
- **Many simple strategies and methods for reducing your Inheritance Tax bill**
- **One simple technique that could save you nearly £100,000 in Inheritance Tax, which does not involve you giving away your assets**
- **About "Reservation of Benefit" and why you need to be aware of it**
- **Why the proceeds of a life assurance policy might not be immediately available to your family on your death, and what you can do to make sure that is.**
- **What is a "business asset" and why investing in these will reduce your Inheritance Tax bill**
- **About Trusts, and how they can save you thousands**

20.1 Introduction

Inheritance Tax is not an easy area to understand – and one of the reasons for this is the fact that, despite its name, it does not just apply to assets passed on when you die – it also applies to **certain gifts that you make in your lifetime**.

We need to explain some basics about the tax, before we can start to tell you how you can reduce it.

There are six areas that we will focus on to explain the basics of Inheritance Tax;

- lifetime gifts

- gifts on death
- how are gifts valued
- how is IHT calculated
- payment of IHT
- how much are you worth?

Lets take each of these in turn.

20.1.1 Lifetime Gifts

Lifetime gifts fall into three categories;

1. Tax-free gifts – these gifts are not subject to any IHT **<u>at any time</u>** and they include;

- gifts to your **spouse,**
- gifts up to a total value of **£3,000 <u>every</u>** tax year (the "annual exemption"),
- **low value gifts** (amounting to £250 per person per year),
- **marriage gifts** – gifts to the married couple of up to £5,000 per parent of the bride or groom, £2,500 per grandparent of the bride or groom and £1,000 from anyone else,
- **maintenance payments,**
- gifts to a **UK registered charity,**
- gifts to **political parties,**
- gifts for **national purposes** (e.g. gifts to museums),
- **regular** gifts **out of income** which form **part of your normal expenditure** (this is explained in more detail later in this Section – see 20.7).

2. Chargeable transfers – these gifts are subject to IHT **at the time that you make them <u>if</u>** the total value of such gifts over the previous 7 years exceeds the IHT threshold (£285,000 for 06/07). They include;

- gifts into discretionary trusts[25],
- gifts to companies.

In these circumstances, IHT will be paid **while you are still alive.** IHT is payable on chargeable transfers at the "**lifetime rate**", which is currently **20%.**

The "lifetime IHT" on a chargeable transfer is normally paid by the person who receives the gift (the "recipient").

*Note: If you (rather than the recipient) pay the lifetime IHT, the tax is calculated on the value of the gift **plus** the tax. Through one of those odd quirks of mathematics, this means that the tax that you pay will be 25% of the value of the gift (and not 20%). For example, if you make a chargeable transfer of £10,000 on which you pay lifetime IHT, the recipient will receive £8,000. The tax paid of £2,000 represents 25% of the gift received.*

Irrespective of whether the lifetime IHT is paid by you or the recipient, it is **deductible** when calculating how much IHT has to be paid on your estate when you die, i.e. your executors will have to pay the IHT that is due on your estate when you die, **<u>less</u>** any lifetime IHT that has already been paid (by you **<u>or</u>** by the recipients).

[25] Discretionary trusts are described in Appendix 2.

3. Potentially-exempt transfers (PETs) – you will not have to pay any IHT on these transfers during your lifetime, but the value of such gifts made in the **last 7 years before your death** is added to the value of your estate when you die.

They include;

- gifts to your friends and relatives,
- gifts to non-charitable organisations, and
- gifts to "interest in possession" trusts[26].

Gifts made more than 7 years before your death are exempt from IHT and are therefore ignored when calculating the value of your assets.

20.1.2 Gifts on death

Certain gifts that you make when you die are "tax-free" and are therefore ignored for IHT purposes – these include;

- gifts to your **spouse,**
- gifts to **UK charities,**
- the proceeds of a life insurance policy which is **written in trust for your dependents** (see 20.6),

If you die before you retire, lump sums paid to your dependents from a personal pension plan or an employee's pension scheme are also normally tax-free.

Generally speaking, all of your assets at the time of your death, apart from those that can be gifted "tax-free", come into your calculation of IHT purposes.

20.1.3 How are gifts valued?

Loss of value

The basic principle is that the value of any gift for IHT purposes is **not** the market value of the gift given away, but is instead **the reduction in the value of your estate** as a result of the transfer.

In many cases, these will amount to the same thing, but in other circumstances, for example when shares are gifted, they may not.

Related property

When valuing your assets you have to take into account "related property". Related property is defined as assets owned by;

- Your spouse; or
- Charities or political bodies which you have donated to them in the **5 years prior to your death**

You will only include the value of **your share** of the related property in your estate for IHT purposes, but it may be that the valuation of a larger holding of an asset places a premium price on the value of the assets that you still own.

[26] Interest in Possession Trusts are described in Appendix 2

EXAMPLE

Ted Nugent owns 26% of "Cat Scratch Fever Limited", an unquoted company, and his wife also owns 26%.

The value of a 52% holding in a company is worth much more than the value of two separately held interests of 26%, as the aggregate holding gives control of the company (and is therefore worth a premium price).

If Ted died, the value to be brought into his estate would be 26/52 (or ½) of the value of a 52% shareholding, and not the value of an individual holding of 26%.

20.1.4 How is IHT calculated?

In summary;

1. A running total is kept of **chargeable transfers** made during a person's lifetime,

2. A transfer drops out of this running total when it is more than 7 years old,

3. If, once a chargeable transfer has been added in to the running total, the running total exceeds the nil-rate band, "lifetime" IHT is paid on the excess over the nil-rate band at a rate of 20%,

4. There is no repayment of any IHT previously paid even if this running total falls below the nil-rate band in subsequent years,

5. Upon death, all **PETs** made in the seven years prior to death are added to the running total,

6. At this time, IHT is payable on any excess of the running total over the nil-rate band, the amount being calculated as;

   (i) 40% of the excess, less

   (ii) any "lifetime IHT" paid on chargeable transfers during the life of the deceased, less

   (iii) any taper relief (see our specific section on Taper Relief in 20.5 below),

7. The value of the **deceased's estate** is added to the running total in 5 above and, to the extent that this exceeds the nil-rate band, IHT is payable at 40%.

   The **deceased's estate** is the total value of his/her assets (excluding those assets which are ignored for IHT purposes) less liabilities (loans, debts) on the date of death **plus** the proceeds of any life insurance policy that has not been written into trust (see later) **less** the cost of funeral expenses.

This is graphically represented by the flowchart overleaf.

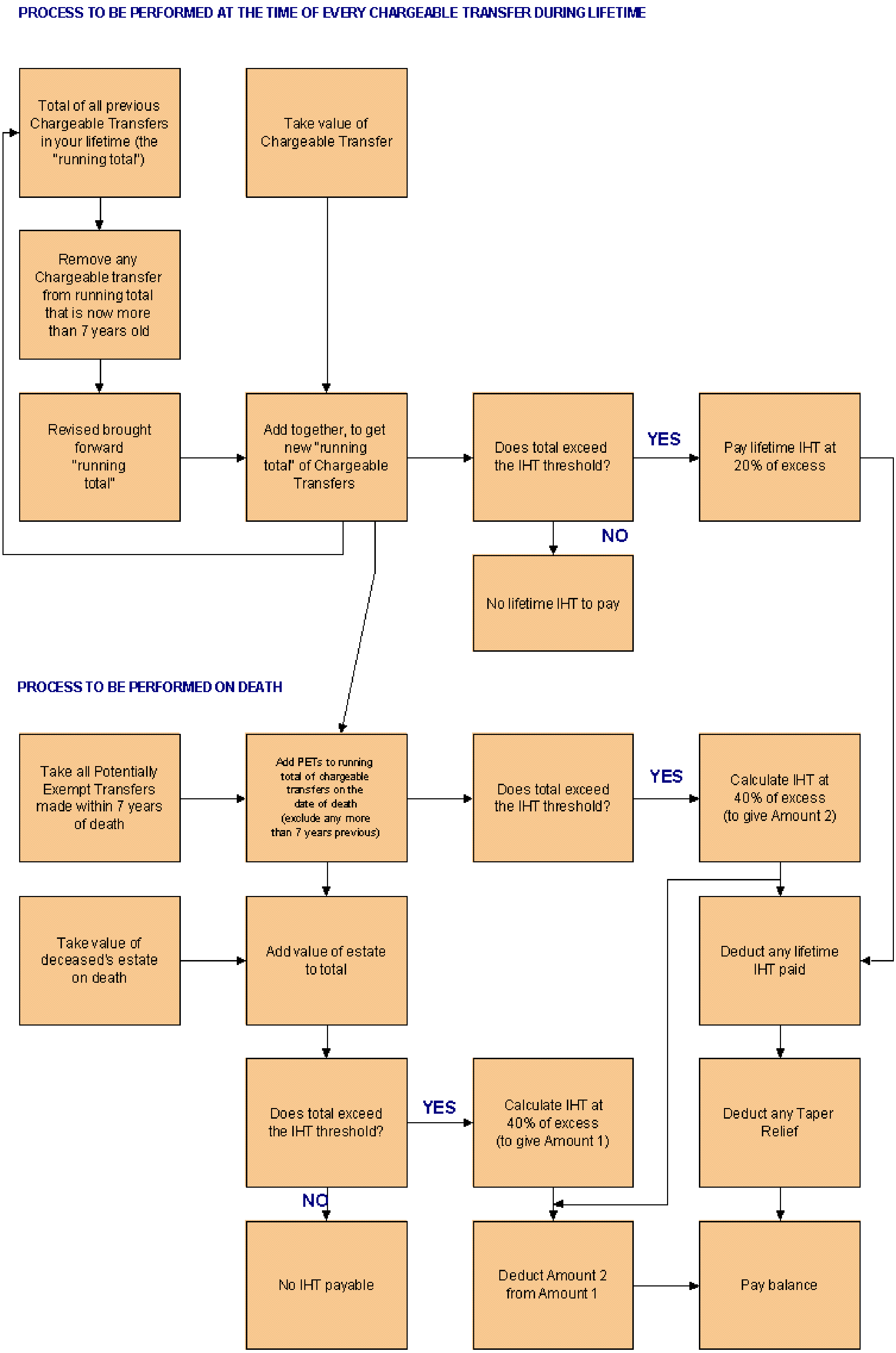
20.1.5 Payment of tax

Your executors are liable to pay the IHT due on your death **within six months** of the end of the month in which you die.

In practice, however, the tax **often has to be paid earlier**. This is because the tax must be paid in order for your executors to obtain formal authority to administer your estate – called "a grant of representation" – and it is only when this has been received that they can start to prove their proper ownership of your assets and **distribute them**.

Funds in your estate **cannot therefore be used to settle the IHT liability**, as the tax needs to be paid **before** the executors can prove that they are entitled to access the funds in your estate. **This is important**.

As a result, it is common for executors to arrange borrowing facilities with a bank to pay IHT.


PROCESS TO BE PERFORMED AT THE TIME OF EVERY CHARGEABLE TRANSFER DURING LIFETIME
Total of all previous Chargeable Transfers in your lifetime (the "running total")
Take value of Chargeable Transfer
Remove any Chargeable transfer from running total that is now more than 7 years old
Revised brought forward "running total"
Add together, to get new "running total" of Chargeable Transfers
Does total exceed the IHT threshold?
YES
Pay lifetime IHT at 20% of excess
NO
No lifetime IHT to pay
PROCESS TO BE PERFORMED ON DEATH
Take all Potentially Exempt Transfers made within 7 years of death
Add PETs to running total of chargeable transfers on the date of death (exclude any more than 7 years previous)
Does total exceed the IHT threshold?
YES
Calculate IHT at 40% of excess (to give Amount 2)
Take value of deceased's estate on death
Add value of estate to total
Deduct any lifetime IHT paid
Does total exceed the IHT threshold?
YES
Calculate IHT at 40% of excess (to give Amount 1)
Deduct any Taper Relief
NO
No IHT payable
Deduct Amount 2 from Amount 1
Pay balance

20.1.6 How much are you worth?

To get a sense of how important it is for **you** to do something about reducing IHT, you should work out how much IHT you would pay if you (and your spouse, if you are married) died tomorrow.

You can do this by using the 7-Step guide provided in 20.1.4 above. You should also the "Statement of Your Assets and Liabilities" that you received FREE with this Guide, to help you calculate what the value of your combined estate is today (which you will need for Step 7 in your calculation).

You may be very unpleasantly surprised by what this calculation shows!

I suggest that you read the rest of this Section, and start to take action to mitigate IHT, if;

- Your calculation shows that you **would pay IHT** if you and your spouse died tomorrow, or
- A **25% increase** in the **value of your property** would cause IHT to be payable on your combined estate, or
- You know that you are a **beneficiary of someone else's will** (for example, a parent) and that, when received, this gift will push the value of your estate above the nil rate band threshold.

For those of you who are not included in these three categories, I recommend that you re-read this introduction every year and re-assess whether the categories apply to you.

Tax Saving Tips

Having explained a little about IHT, lets move on to how you can save IHT.

20.2 Lifetime gifts

20.2.1 Make gifts in your lifetime

The most basic of IHT saving Tips is that, where you can, you should look to make **lifetime gifts**, i.e. make gifts to people while you are alive.

Your estate when you die will not include;

- all "tax-free" gifts (see 20.1.1 above) made during your lifetime, and
- all PETs and chargeable transfers made **more than 7 years** before your death.

Making lifetime gifts will therefore reduce the value of your estate when you die, thereby reducing the Inheritance Tax payable.

TIP	If your estate is worth more than the nil-rate band, have a policy of making gifts regularly		
SAVE	£1,000's	**EASE OF USE**	Simple
CONSIDER	Your own financial security (see 20.2.3 below) Capital Gains Tax that may be payable on assets that you gift (see 20.2.4 below)		

20.2.2 Give assets the value of which is likely to increase most

When you are giving assets, try to give those whose value has the greatest growth potential, as this will reduce your future tax liability the most.

If you die within 7 years of making the gift, only the value **on the date of the gift** will be brought into your Inheritance Tax calculations, and not the growth in its value after that date.

TIP	Give assets whose value has the greatest potential for growth		
SAVE	£1,000's	**EASE OF USE**	OK

20.2.3 Don't compromise your own financial security

When considering whether to give assets away, you must consider your own personal financial situation and your future financial security.

If you have given away too many assets, there is no obligation on anyone to give them back to you or to use them to look after you.

You need to think very carefully about what will happen if you are unable to care for yourself in the future. Always err on the side of caution and make sure that you don't give away too much.

TIP	Be cautious when giving away assets

20.2.4 Beware of Capital Gains Tax

Most assets that you give away during your lifetime will be liable to **capital gains tax**, based on the **market value** of the asset when the gift is made. So, whereas you will be saving inheritance tax by making gifts, you may be incurring capital gains tax instead.

In deciding whether to give assets in order to save IHT, you will therefore need to consider;

- what, if any, Capital Gains Tax you will have to pay on the gift. Remember that you will pay Capital Gains Tax on any chargeable gains above your annual CGT allowance at a rate of 20% if you are a basic rate taxpayer and 40% if you are a higher rate taxpayer. How does this Capital Gains Tax bill compare to the IHT that you are potentially saving as a result of making the gift?

- the fact that CGT is payable by you **now**, whereas IHT is only payable out of your estate **when you die**;

- your own **financial security** (see 20.2.3 above).

TIP	Take care. Consider your overall tax position and make sure that you are not replacing an IHT bill with a higher CGT bill.		
SAVE	£1,000's	**EASE OF USE**	OK

20.2.5 Give assets that are exempt from CGT

One way in which you can avoid both IHT and Capital Gains Tax is to make lifetime gifts of assets that are **exempt** from Capital Gains Tax, such as chattels worth under £6,000 (see 19.14 for a full list of these assets).

Gifting of CGT exempt assets will reduce your estate for Inheritance Tax purposes, but will not create a CGT bill.

TIP	Gift assets that are exempt from capital gains tax		
SAVE	£1,000's	**EASE OF USE**	OK

20.2.6 Make Chargeable Transfers before Potentially Exempt Transfers

When making lifetime gifts, it is **very important** that, wherever possible, you make gifts that are Chargeable Transfers (e.g. gifts to Discretionary Trusts) **before** you make any PETs.

The reason for this is explained in 20.5 below.

TIP	Make Chargeable Transfers before PETs.		
SAVE	£1,000's	**EASE OF USE**	Simple

20.3 Reservation of Benefit

If you do not give assets fully, and you **retain use or enjoyment of the asset**, then the asset will remain in your estate for IHT purposes. This is termed "**reservation of benefit**".

Here are some situations which illustrate when the Inland Revenue will treat the asset as remaining as yours;

- If you give your house to one of your children, but you remain living in the house rent free,
- If you give your house to one of your children, but you stay with your child for more than one month a year, or for more than 2 weeks a year while your child is away,
- If you give your car to a grandchild and you are given more than 2 lifts in the car a month,
- If you give a painting to one of your children, but it remains hanging in your house.

These examples illustrate how aggressively the Revenue seeks to impose the "reservation of benefit" ruling.

There is no reservation of benefit when you **pay a market rental** for using the property or asset which you have given away, but this rental will be subject to income tax in the hands of the recipient.

TIP	Do not reserve benefit in an asset if you want to save IHT		
SAVE	£1,000's	**EASE OF USE**	Simple

20.4 Annual exemption

Each person has an "annual exemption" of gifts up to a total value of £3,000 **every** tax year. You can make this value of gifts **each and every year** without worrying about IHT. This means that gifts covered by this annual exemption are not brought into your IHT calculation **no matter when they were made**.

Furthermore, if you don't use all of the annual exemption of £3,000 in one year, you can carry forward the unused amount to use in the following year.

Two points on this;

- You can only carry forward the unused exemption **one** year, and
- The current's year's exemption is used up **before** any amount brought forward from the year before.

EXAMPLE

You make a gift of £2,000 in 2004/05 and a further gift of £3,250 in 2005/06.

The gift in 2004/05 is exempt from IHT (as it is below your annual exemption of £3,000) and you carry forward an unused annual allowance of £1,000 to 2005/06.

The gift of £3,250 in 2005/06 is also exempt from IHT, based on the use of the annual exemption for 2005/06 of £3,000 and £250 of the unused allowance brought forward from 2004/05. The remainder of the allowance that was brought forward from 2004/05 (£750) cannot be carried forward to 2006/07 and is lost.

TIP	Where possible, use your "annual exemption" each year. If you don't, try to use up the unused exemption in the following year.

SAVE	£1,000's	**EASE OF USE**	Simple
CONSIDER	Your own financial security (see above)		

20.5 Taper relief

On death, all Potentially Exempt Transfers that occurred in the previous 7 years become Chargeable Transfers.

However, if the gift was made more than 3 years before death, any IHT payable on that gift will be reduced by "Taper Relief".

Taper relief is basically a reduction of the tax that is payable, the amount of which increases the longer the time between the gift being made and the death of the donor. Figure 21 below shows how Taper Relief works.

This sounds simple, but in practice it is not easy to calculate.

We spend the next page and a half or so illustrating how Taper Relief is calculated, which gets a little complicated in parts! If you want to skip this bit, you can turn straight to the tax saving tip at the end of this paragraph – the tip itself is pretty simple and you can understand it without having to read the relatively complex calculations that follow.

In order to calculate whether taper relief applies;

- all Chargeable Transfers (including PETs) that occurred within 7 years of death are accumulated into a running total, **taking the earlier gifts first**,
- if there are any gifts that were given more than 3 years before the date of death **and** the running total that is in excess of the nil-rate band at the time that the gift was made, then taper relief will apply.

Figure 21: Taper Relief

Years after gift made	% of tax payable
0 – 3	100%
3 – 4	80%
4 – 5	60%
5 – 6	40%
6 – 7	20%
Over 7	0%

Lets illustrate this with a couple of examples;

EXAMPLE

The only lifetime transfer made by Jim Kidd, a widower, is a gift of £345,000 on 19th August 1998 to his daughter. Jim dies in July 2003, leaving an estate at death of £320,000.

At the time that he made the gift, £339,000 of it (being £345,000 less two year's annual exemptions[27]) was a PET, but Jim's death within 7 years of the gift makes it a chargeable transfer.

The nil-rate band for 2003/04 was £255,000, so £84,000 of the chargeable transfer is taxable at 40%, giving IHT due of £33,600. However, the gift was made over 4 years before his death, so only 60% of this tax is payable as a result of Taper Relief, or £20,160.

[27] See 20.4 for an explanation as to why Jim gets two annual exemptions.

In addition, Jim's estate falls completely above the nil rate band (the "running total" is increased from £339,000 to £659,000 by the inclusion of Jim's estate), so tax is payable on Jim's estate at 40% = 40% x £320,000 = £128,000. Total IHT will therefore need to be paid on Jim's death of £148,160.

EXAMPLE

*Peter Smith made the following gifts in his lifetime (**after** taking annual exemptions into account);*

12 May 1995	*To brother*	*£25,000*
3 July 1996	*To son*	*£75,000*
5 May 1997	*To daughter*	*£75,000*
28 September 1998	*To son*	*£120,000*
15 October 1999	*To discretionary trust*	*£240,000*
16 July 2000	*To sister*	*£25,000*

Peter died on 2 July 2003, leaving an estate of £750,000. The nil rate threshold for 2003/04 was £255,000.

*The only **Chargeable Transfer** during Peter's lifetime was the gift to the discretionary trust.*

At the time of this gift, the nil rate band was £231,000. The "lifetime IHT" payable on this gift was therefore;

£9,000 (being £240,000 less £231,000) x 20% = £1,800

*On Peter's death, all **PETs** in the previous 7 years become chargeable transfers. So the first gift to his brother is ignored (as this was more than 7 years before his death). The other gifts, however, become chargeable transfers.*

To calculate IHT, we first need to calculate a running total of gifts, taking the earliest first.

Date	***Gift***	***Running Total***
3 July 1996	*75,000*	*75,000*
5 May 1997	*75,000*	*150,000*
28 September 1998	*120,000*	*270,000*
15 October 1999	*240,000*	*510,000*
16 July 2000	*25,000*	*535,000*

Taking each gift in turn;

No IHT is payable on the first two gifts, as the running total is less than the nil-rate band that applies in 2003/04, of £255,000.

The running total first exceeds the nil-rate band of £255,000 with the gift to Peter's son on 28th September 1998. The excess over the nil-rate band is £15,000 (£270,000 less £255,000), on which tax is payable at 40%, giving £6,000. However, the gift was made more than 4 years before Peter's death, so this tax is reduced by taper relief. Taper relief will reduce the tax payable to £3,600 (i.e. 60% of £6,000). If the tax is not paid by Peter's estate, the tax will have to be paid by Peter's son.

All of the gift to the discretionary trust falls above the nil-rate band (the running total increases from £270,000 to £510,000), so it is fully taxed at 40%. This gives a tax charge on this gift of £96,000. This is reduced by the lifetime IHT of £1,800 that was paid by Peter during his lifetime, giving a tax payable of £94,200. If this tax is not paid by Peter's estate, it will have to be paid by the trust. There is no Taper Relief as the gift was a chargeable transfer and not a PET.

All of the gift on 16th July 2000 to his sister falls above the nil-rate band (the running total increases from £510,000 to £535,000) and is therefore fully taxed at 40%. IHT of £10,000 (40% of £25,000) is payable. No taper relief applies as the gift was made less than 3 years before Peter's death.

Peter's estate is then added to the running total, to give a final total of £1,285,000. All of Peter's estate therefore falls above the nil-rate tax band, so it is taxed fully at 40%, giving a tax payable on his estate of £300,000 (being £750,000 x 40%).

The total tax payable on Peter's death is therefore £407,800 – being £3,600 plus £94,200 plus £10,000 plus £300,000.

As the above examples show, the whole area of taper relief, chargeable transfers and PETs is fairly complex, however the tax-saving advice is pretty straightforward.

TIP	Make all gifts as soon as possible. This will increase the chance that they will be exempt from IHT or, at least, maximise the Taper Relief that can be claimed.		
SAVE	£1,000's	**EASE OF USE**	Simple

In 20.2.6 above we mentioned the importance of making Chargeable Transfers before PETs. This can now be illustrated using the above Example.

If the gift to the discretionary trust had been made **before** 3 July 1996, and not on 15 October 1999, the 3 PETs that Peter made to his son and daughter in 1996, 1997 and 1998 would **all** have been available for Taper Relief (as the running total at the time that they were made would have been above the nil-rate band). By being able to claim Taper Relief on these gifts, Peter's overall IHT liability would have been reduced by nearly **£50,000**.

As you can see, the importance of the chronological order in which you make gifts cannot be underestimated.

20.6 Life assurance policies

If you take out a life assurance policy on your own life, you need to make sure that the policy is "**written in trust**" for the benefit of another person (who will normally your spouse, or a trust for the benefit of your children).

By doing this, the policy will pay out on your death, but the money will **not** form part of your estate for IHT purposes.

This is commonly used to make sure that your survivors have enough money to pay any IHT due on your death, without having to sell any of your assets (including your home).

This sounds complicated, but it isn't. All life insurance companies will be able to advise you what to do.

Note: Whilst the premiums that you pay for such a policy are potentially gifts that need to be brought into the IHT calculation on your death, they will normally be exempt from IHT because they can be treated as "normal expenditure out of income" (see 20.7 below).

TIP	Write life assurance policies "in trust" for the benefit of your spouse or surviving children		
SAVE	£1,000's	**EASE OF USE**	OK
What you need to do	Any life insurance company will be able to advise you how to write policies "in trust".		

20.7 "Normal expenditure out of income"

This is an **extremely valuable exemption** for people with high incomes.

If you can demonstrate that you **consistently** had an excess of income over the costs of your normal standard of living over several years, you are allowed to **give away the excess without suffering IHT** on any such transfers. Such gifts will not be brought into your estate when you die, whenever you made them.

This is termed an exemption for "**normal expenditure out of income**".

For this exemption to apply, you have to be able to show a **customary pattern** of making gifts, which will normally require you to repeat the gifts for a period of 3 or 4 years.

It is **not necessary** that the gifts are made to the same people, or for the same amounts.

Where the **intention** to establish a regular gift is established **at the outset** (e.g. by entering into a life assurance policy which requires the payment of a regular premium), then the exemption will be available for the first gift even if none are made thereafter because of your death.

The onus of proof will be on your executors after your death, so you should ensure that you retain the necessary details of your income and expenditure over a long period.

TIP	If you receive substantially more income than you spend on maintaining your normal standard of living, you will not pay an IHT on regular gifts that you make out of this excess over a sustained period		
SAVE	£1,000's	**EASE OF USE**	OK
What you need to do	Keep documentation to prove what your income and expenditure was over a long period Keep to a regular programme of giving		

20.8 Insure against a IHT bill

If you **receive** a PET or a chargeable transfer from someone, **you** have a potential liability to IHT. However, you do not know how much the liability is going to be at the time that you receive the gift.

This is because the actual IHT that will eventually be payable on the PET or chargeable transfer will depend on;

- how long the donor lives,
- the value of the other gifts that the donor has made in the 7 years before his death, and
- whether the IHT on the transfer is paid by the donor's estate.

If you receive such gifts, you should consider taking out **temporary insurance cover** on the life of the donor, which will pay out a sum on the death of the donor sufficient to pay any tax that will be due.

The cover will be reduced gradually year-by-year once the donor has survived more than 3 years after the gift, to reflect the fact that the potential IHT liability is reducing.

TIP	Take out insurance to cover your potential IHT liability		
SAVE	£1,000's	**EASE OF USE**	OK
What you need to do	Talk to any life insurance company and they will be able to advise you what you need to do.		

20.9 Equalise your estates

If you are married, it is obviously impossible to know whether you or your spouse will die first.

If your combined estates are large, your combined inheritance tax bill will be much lower if you can **each** make use of the lifetime gift exemptions and the nil-rate band on death.

To achieve this, married couples need to look to "equalise" the value of their respective estates, at least to the extent that they **each own assets to a value exceeding the nil-rate threshold.** Estate "equalisation" means making the total value of assets that are legally owned by each spouse broadly the same.

If each spouse owns assets **well in excess** of the nil-rate threshold, this will;

- allow for future increases in the threshold (thereby making sure that each of you can use the full amount of the nil rate band when you die, without having to make any further transfers of assets),

- allow each spouse to engage in a regular policy of lifetime giving (without bringing down the value of their estates to below the nil rate band threshold), and

- allow you to give away £6,000 per year completely exempt from any Inheritance Tax (using both spouse's annual exemption).

However, asset ownership has implications for other taxes, most particularly income tax. **Remember** that it might be desirable for investments to be owned by the lower rate taxpayer to minimise income tax.

You will need to make sure that you consider **all of the tax implications** of your preferred asset ownership structure before putting it in place.

TIP	If you are married, it is a good policy to try and equalise the values of the estates of both spouses		
SAVE	£1,000's	**EASE OF USE**	OK
CONSIDER	The income tax implications of changing asset ownership. Remember there are **no** CGT implications of transferring assets between spouses.		
What you need to do	Calculate the respective values of each spouse's estate Decide whether there are any assets that the spouse who has the higher value estate is comfortable giving to the other spouse Consider the income tax implications of making these gifts Make sure that the legal title to the chosen assets is properly transferred.		

20.9.1 Joint ownership of the home

An extremely common mistake when equalising estates is for couples to assume that, **if** they have a joint mortgage, then they own half of the house each. **This is rarely the case**.

In almost all cases, houses are owned under a "Joint Tenancy". This means that if one person dies, their half of the property automatically passes to the survivor **before any Will comes into effect**. As such, the deceased's half of the property is not treated as part of their estate. A "Joint Tenancy" arrangement does not therefore equalise estates.

To share the house equally, joint owners need to be "**Tenants in Common**". Under this arrangement, each joint owner is treated as owning half of the house and, if one of the joint owners dies, the value of half of the house is brought into their estate for IHT purposes.

A "Joint Tenancy" arrangement can be changed to a "Tenants in Common" arrangement by;

- one party writing to the other stating that they want to make this change,

- the other party signing the letter in agreement,

- both parties writing to the Land Registry and to their mortgage lender, informing them of the change in the legal ownership of the house.

We would recommend that you take **legal advice** to ensure that this change is made correctly.

TIP	If you jointly own a house, make sure that it is on a "Tenants in Common" basis if you are looking to equalise your estates for IHT purposes.		
SAVE	£1,000's	**EASE OF USE**	OK

What you need to do	Decide whether you need to share the ownership of your house(s) to equalise your estates Confirm the legal basis on which you own your house(s) at the moment Ask a solicitor to help you to change “Joint Tenancy” arrangements to “Tenants in Common” arrangements, where required.

20.10 “Reversionary Interest”

A Reversionary Interest is an entitlement that you have to receive assets or income **at some point in the future** when someone else’s enjoyment of the assets or income has ended.

ILLUSTRATION

If your mother is currently entitled to the income of a trust and on her death you will become entitled to the capital of the trust, you have a reversionary interest in the trust.

If you have a reversionary interest, you should consider making a gift of this interest to your children or into a trust for their benefit.

If you do, the gift of the reversionary interest will not be chargeable to inheritance tax even if you die within 7 years of its transfer and the underlying assets will generally not form part of your estate.

If you wait until you actually receive the assets before giving them away, the gifts will be taxed under the standard IHT rules (and therefore you will have to survive for 7 years from the date of the gift to avoid paying IHT on them).

TIP	Save IHT by gifting reversionary interests		
SAVE	£1,000’s	**EASE OF USE**	OK
What you need to do	Talk to a solicitor, who will be able to advise you how to make a gift of a reversionary interest.		

20.11 Business property relief

20.11.1 Favourable treatment of business assets

Business property relief is available on gifts of business property, **either during your lifetime <u>or</u> on your death**, providing certain conditions as to the length of ownership and type of asset are satisfied.

The relief is given as a **percentage of the value of the assets transferred** (and **<u>not</u>** as a percentage of the tax that is due), as outlined in Figure 22 overleaf.

Figure 22. Business Property Relief

Type of asset that is gifted	Relief (%)
A business or interest in a business (including a partnership)	100%
Shareholdings in unquoted companies [28] [29]	100%
A controlling shareholding in a quoted company	50%
Land or buildings, machinery or plant used for a business that is carried on by; • a company of which the donor has control, or • a partnership in which the donor was a partner, or • the donor, being settled property in which he had an interest in possession	50%

In order to qualify for this relief, the assets must have been owned by the donor **throughout the previous two years**.

The relief is applied automatically without a claim.

The relief is applied to the ***value*** of the assets transferred, before the application of any exemptions, and **not** to the tax that is payable as a result of the transfer. The amount brought into the "running total" of gifts that we have described previously is therefore the value of the asset transferred, **less** the amount of any business property relief, **less** any other allowances.

You can therefore reduce the IHT that is payable when you die by investing in assets that will benefit from "business property relief".

TIP	Individuals can reduce IHT bills by investing in business property, as outlined in Figure 22 above.		
SAVE	£1,000's	**EASE OF USE**	OK
CONSIDER	IHT will be only one of many factors that you need to consider when deciding where you should invest your money, but it is an important one. If it is not important to you that you maximise the amount of income that you earn from your investments **and** your taxable estate is likely to be higher than the nil rate band, you should consider investing some of your money in business property, as described above.		

20.11.2 Give business assets now

The rules and regulations regarding business assets are currently very favourable.

You should consider taking advantage of them **now**, before they change, **by making gifts of** any **business property** that qualifies for the relief described above.

TIP	Make gifts of business property **now** to take advantage of the favourable tax relief		
SAVE	£1,000's	**EASE OF USE**	Simple

[28] Shares on the Alternative Investment Market (AIM) are treated as unquoted shares.

[29] Relief is not available on either quoted or unquoted shares where the business consists of dealing in stocks and shares, in land and buildings or in holding investments

20.12 Gift and loan back arrangements

A “gift and loan back arrangement” is a scheme that has been marketed for several years by insurance companies, which works well in minimising IHT. It works as follows;

> You pay a one-off premium to take out a life insurance policy on your life. This policy is written “in trust” for your chosen beneficiary. This requires you to establish a trust and appoint trustees, although the insurance company that sells the policy to you will be able to help you to do this.
>
> You then make a substantial interest-free loan to the trustees. At this stage your estate has not reduced at all – you have just replaced cash with an asset (being an amount owed to you by the trustees).
>
> The trustees then use the loan to make an additional payment into an investment bond that is linked with the life insurance policy.
>
> As we have previously described in 10.16.1, it is possible for “5% withdrawals” to be made from such bonds tax-free. Thus, the trustees can withdraw 5% of their original payment each year and use this to repay the loan to you over 20 years, and you can use these funds to live on.
>
> This arrangement means that;
>
> - Over the course of 20 years, you will get your money back. You will not pay tax on the funds that you receive, as they are repaying your original loan;
> - Any growth in the value of the bond will fall outside of your estate and will be held for the benefit of your beneficiary.

A gift and loan back arrangement thereby effectively passes money (investment gains) to your beneficiaries without IHT, whilst allowing you to use the funds that have been invested.

TIP	Consider a “gift and loan back” arrangement as a way of passing money to your beneficiaries free of IHT		
SAVE	£1,000’s	**EASE OF USE**	OK
What you need to do	Speak to an IFA.		

20.13 Skip a generation

If you are from a wealthy family, it is a good plan if grandparents always provide for grandchildren, so that each generation passes its assets down two generations.

This gives the generations more time to plan how to minimise IHT, and it defers any payment of IHT that will eventually be made.

TIP	Gift assets to your grandchildren to prevent your children from having to pay IHT on their estate		
SAVE	£1,000’s	**EASE OF USE**	Simple
CONSIDER	You will need to be certain of your children’s financial security before you consider this as a viable way of deferring an IHT bill.		

20.14 Make a will

Don't leave it too late; without a will, the courts may have to decide who looks after your children and the Inland Revenue may take a part of your children’s legacy in Inheritance Tax.

A will;

- **appoints executors** to **administer your estate** (your executors are the people who give out your assets in accordance with your wishes and who pay any tax due on your death out of the money that you leave in your estate),

- sets out **who** you wish to **inherit** your assets on your death,

- sets out any **conditions** on which the assets are to pass to your chosen heirs,

- sets out your desired funeral and burial arrangements – so, if you want your ashes scattered on your favourite football's team pitch, or if you want "Hot in here" by Nelly played as you are cremated, you need to state this in your will.

A will makes it much **easier** and **cheaper** to sort out your estate when you die.

If you **do not** have a will;

- the Court will need to appoint administrators to sort out your estate, and these administrators are chosen from those who are legally entitled to receive your assets. They may not be the persons that you would ideally want to do this work,

- your assets will generally pass to your heirs in a defined way, known as "**intestate succession**", although this can be varied by the courts if there were people who were financially dependent on you when you were alive. The laws of "intestate succession" are described in Appendix 8, and

- the Court will need to appoint a "guardian" to look after your children, if you are not survived by your spouse.

TIP	Make a will		
SAVE	£1,000's	**EASE OF USE**	OK
What you need to do	Spend £100 to £150 getting a solicitor to draw up a will for you (or a set of mirror wills for you and your spouse). Buying a set of standard forms from your local stationers, where all you do is "fill in the blanks", can often be a false economy. If you are wealthy enough to be worried about paying IHT, pay a bit more for your will and know that it does exactly what you want it to do.		

20.15 Lottery syndicates

If you are part of a lottery syndicate, make sure that you have a **written agreement** setting out how the syndicate is **to be managed**. If you do not have an agreement, the person who collects the prize and then shares it out may be considered to be making a gift for Inheritance Tax purposes.

TIP	Have a written agreement confirming how a lottery syndicate is to be managed.		
SAVE	£1,000's	**EASE OF USE**	OK
What you need to do	Keep it simple. Just one piece of paper, stating who will contribute what, who will buy the tickets and how the winnings will be shared out will be enough, as long as it is signed by each member of the syndicate. To avoid arguments, it should also explicitly state what happens if a member of the syndicate does not pay his or her contribution on time.		

20.16 Trusts

What is a Trust?

Essentially, a Trust is an arrangement whereby one person ("**the Settlor**"), transfers assets to another person, whom he has appointed ("**the Trustee**"), and instructs the Trustee to use those assets, and any other assets which may subsequently be added to them, strictly for the benefit of other persons ("**the Beneficiaries**").

The Settlor may be, and often is, a Beneficiary and usually the other Beneficiaries will be members of the Settlor's family. They can however be any persons nominated by the Settlor.

The Settlor's instructions are contained in a written document, which is called the "**Trust Deed**". The Deed ensures that the Settlor, the Trustee and the Beneficiaries know their respective rights and duties.

The Trustee must **always** act in the best interests of the Beneficiaries. The Trustee therefore has the **legal ownership** and **control** of the assets but he or she **cannot benefit from them** - the benefit is for the Beneficiaries only.

In simple terms, then, a Trust involves one person giving assets to a second person, who then has to use those assets for the benefit of, and eventually give those assets to, a third person (or persons) whose identity is determined by the first person.

We need to make two important points before we go any further:

- firstly, a **word of warning**. Trusts are **complicated** and you will need to take legal advice if your are interested in pursuing tax saving measures which involve Trusts,

- secondly, if you do not know anything about Trusts, please read Appendix 3 before you go on to read the next few Tips in this Section. The Appendix describes the various different types of Trust in some detail.

In general terms, there are two main advantages of Trusts from an Inheritance Tax point of view;

- trusts are a way of giving to your children when they are young, without giving them outright ownership of the assets themselves. By giving when your children (and you!) are young, you are **increasing the chance** that **you will survive for at least 7 years** after making the gift, thus reducing the chances that IHT will be payable on your gift into the Trust;

- the assets that you gift to a trust can **grow in value outside your estate -** once you have gifted assets to a trust, any increase in value in these assets has no effect on your estate for Inheritance Tax purposes.

TIP	Put money into a Trust		
SAVE	£1.000's	**EASE OF USE**	Complex
What you need to do	Take legal advice		

Having established the general principle that Trusts can save you Inheritance Tax, lets discuss some specific examples.

20.16.1 Accumulation and Maintenance Trust

WARNING: The 2006 Budget proposed changes to the tax treatment of A&M trusts. If these changes are passed, many of the tax advantages of an A&M trust (as explained below) will be removed. This book will be updated once the Government's position is definitive.

If you have young children, an Accumulation and Maintenance Trust is a great way of providing in a tax-efficient way for their future.

If you do not know what an Accumulation and Maintenance Trust is, or how it differs to other common types of trust, have a quick look through Appendix 2 now.

Not only does an A&M trust provide the Inheritance Tax benefits that were outlined in 20.16 above, but also, if income earned on the Trust's assets is paid out to children for their "benefit" (for their education or maintenance), then;

- this does not create any income tax liability on the parents of the children (as it would if assets had been given to each the child and these assets generated more than £100 per year in income – see 5.6); and,

- to the extent that the child has unused personal tax allowances, the child can recover the 34% income tax that has to be paid by the Trust on income earned by assets in the Trust.

Young children will therefore effectively receive the gross income earned by the Trust (up to the value of their personal allowance) and this can be used to provide for their education.

TIP	An Accumulation and Maintenance Trust is a very effective way of providing for the education and maintenance of your young children		
SAVE	£1,000's	**EASE OF USE**	Complex
What you need to do	Take legal advice		

20.16.2 "Nil rate band" trust

With property prices at an all-time high, and most mortgages carrying life insurance cover which ensures that the debt is paid off at death, a large number of married couples have a combined estate worth well in excess of the IHT threshold. This can give rise to large, and **unnecessary**, IHT payments.

EXAMPLE

Tosh and David Peckham each have an estate of £250,000. They wish to give everything to the survivor when the first one dies, and on the second death they wish everything to go to their children, Hope and Charity.

On David's death (it would apply equally if Tosh died first) everything passes to Tosh free of Inheritance Tax.

On Tosh's death, her estate is worth £500,000, which gives a liability to IHT of £98,000. Only £402,000 passes to the children.

There is a way around the problem highlighted by the above example, which is illustrated by the example below.

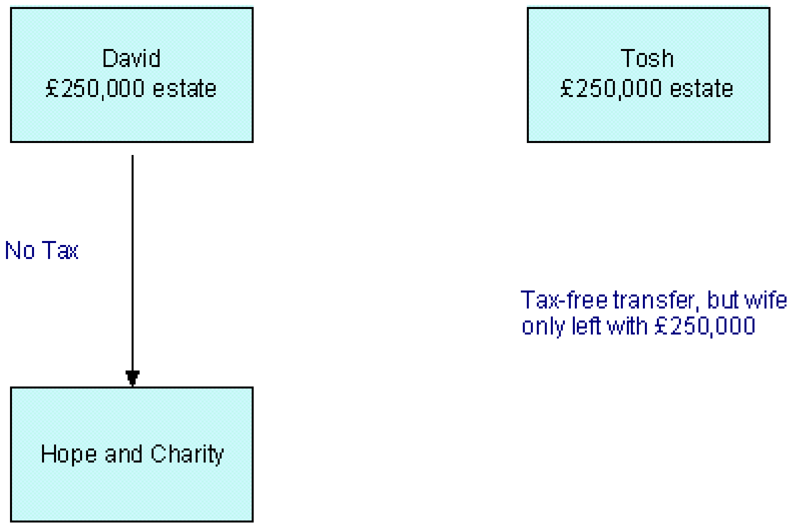
EXAMPLE

*Taking the same example as before, lets say that Tosh and David do not give everything to the survivor when the first one dies, but instead they each give their estate directly **to their children**.*

On David's death (it would apply equally if Jane died first), David therefore leaves his estate to their children. No Inheritance Tax is payable as his estate his less than the IHT nil rate band.

Tosh's estate would still be worth £250,000 (as none of David's assets have passed to her) and so, on her death, no Inheritance Tax would again be payable. Tosh and David's children would receive £500,000 under this arrangement – a saving of £98,000 of IHT.

So;



However, the arrangement explained in the example above has one major disadvantage, and that is that Tosh would have **no control** over the money that David left to their children. As a result, she would not be able to use it for her purposes and she might end up being short of money. She might even have to sell the family home in order to survive.

However, there is a way round this problem too. We apologise for dragging this out, but it is important that you understand the disadvantages of the usual arrangements before providing you with the solution!

The solution is to use something called a "**nil rate band discretionary trust**". This provides the IHT benefits of the last example above, whilst still allowing the surviving spouse to benefit and control the deceased's estate. Lets show you how this works using the prior example.

EXAMPLE

In his will, David leaves his estate of £250,000 to the trustees of a discretionary trust, the beneficiaries of which are Tosh and David's children. The trust deed allows Tosh to borrow from the Trust up to £250,000.

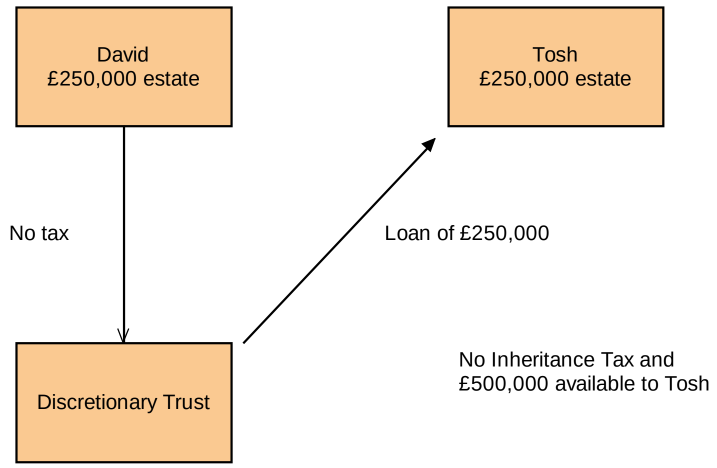
Thus, Tosh is not left short of money and the family home does not have to be sold. In terms of IHT;

- No tax is payable on David's death as his estate is below the nil-rate band level;

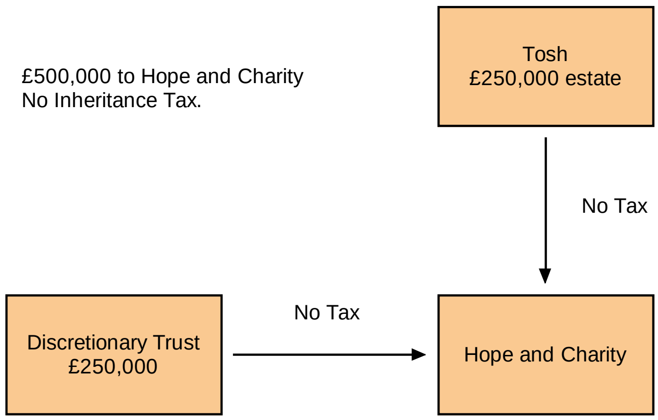
- No tax is payable on Tosh's death as the discretionary trust is outside her estate, and her estate is therefore valued at £250,000 which is below the nil-rate band.

The children therefore receive £500,000 without any deduction of IHT and Jane experiences no financial hardship or inconvenience.

Step 1: On David's death



"Step 2": On Tosh's death:



In order for this trust to work, it is vital that you prepare your estate properly. By this I mean that;

- If your combined estates are worth more than twice the value of the nil rate band (being £570,000 for 06/07), then you need to ensure that each of your estates are worth at least the amount of the nil rate band (£285,000 for 06/07),

- If your combined estates are worth more than the value of the nil rate band, but less than twice the value of the nil rate band, then you will benefit from equalising the value of your estates.

You should refer to 20.9 for some advice on “equalising your estates”.

In practical terms, there are 3 ways in which the legacy of £250,000 to the Trust can be satisfied on the death of the first spouse;

- Cash of £250,000, or

- Promise of payment from the surviving spouse for £250,000, or

- Putting a charge on the home to the value of £250,000.

The nil-rate band discretionary trust is a very neat solution to a practical problem that affects a lot of families today.

TIP	Married couples should set up a "nil rate band" discretionary trust to pass assets worth twice the value of the nil rate band to their children		
SAVE	£100,000	**EASE OF USE**	Complex
What you need to do	Take legal advice		

20.16.3 Two-year will trust

As non-one knows exactly when they are going to die, or the financial circumstances of his or her family at the time, it can often be difficult to take full advantage of tax exemptions and reliefs in your will in case you deprive a dependent of much needed income or capital just to save tax.

If you are unsure how much you should leave, to whom, and what you should do to minimise the IHT that you pay, you should consider setting up a **two-year discretionary will trust**.

Under this arrangement, you leave all of your assets to the trustees of a discretionary trust. **You** determine the potential beneficiaries of this trust in your will, but the **trustees** decide who gets what after you die.

The responsibility is therefore put on the trustees to assess the family's circumstances at the time of your death and to distribute assets accordingly. The flowchart overleaf shows an example of how the Trustees could decide what to with your assets after your death to avoid paying any IHT.

Provided that the trustees distribute the assets more than **3 months**, but **no greater than 2 years**, after your death, the distribution of assets is treated as though it had happened **when you died**, and IHT is calculated on this basis.

If you wish to use a discretionary will in this way, you should **leave a letter** with your will explaining to your trustees how you wish them to exercise their powers.

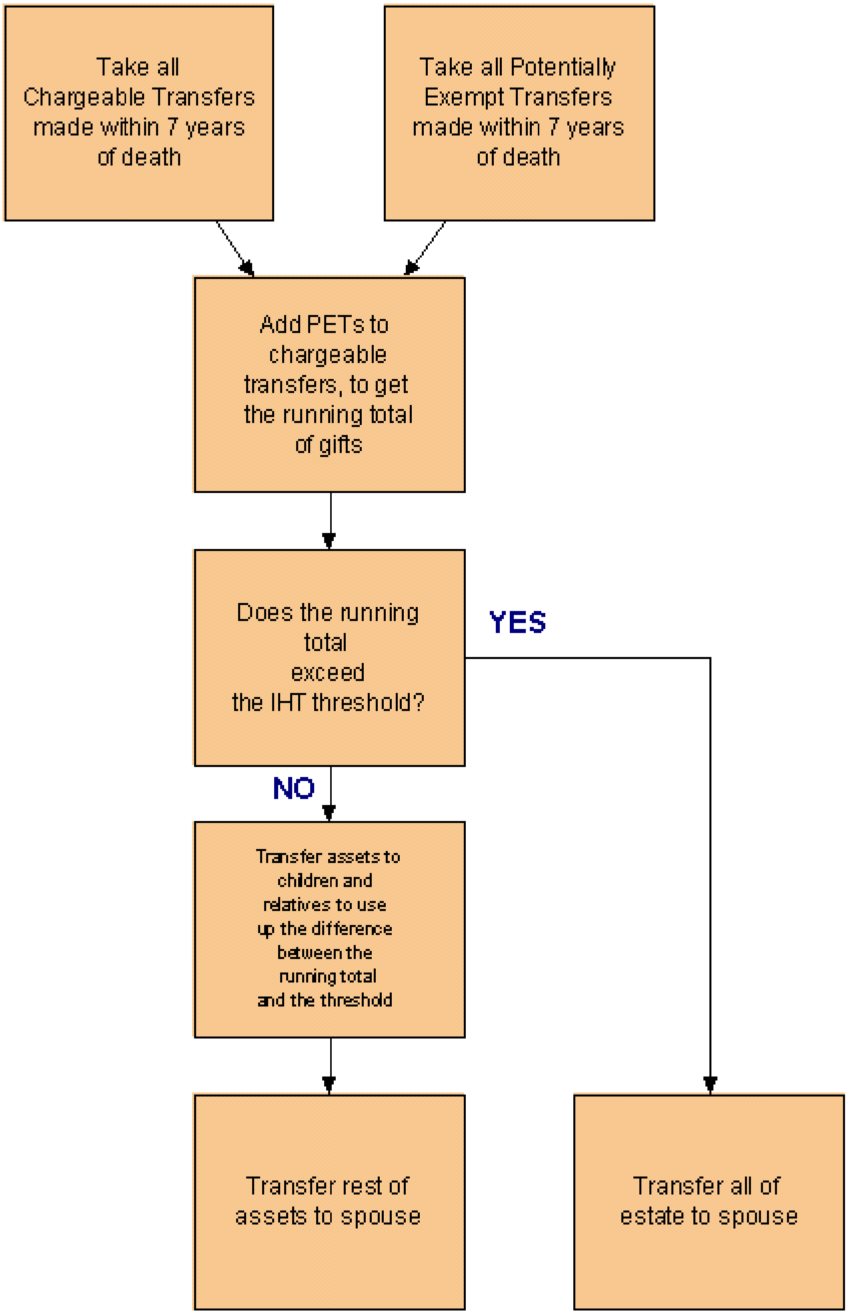
A "two year will trust" effectively **gives you the benefit of hindsight**, and allows your trustees to distribute your estate in the best way that will minimise IHT.

It is particularly useful where you have made a high value of PETs during your lifetime.

The disadvantage of a two-year will trust is that IHT will be payable initially on the value of all assets gifted to the trust over and above your nil-rate band (£285,000 for 06/07).

Whilst this tax will be recoverable, **once the assets have been distributed by the trustees**, your trustees may be required to sell some of your assets to raise money to pay the initial IHT bill.

THE TWO-YEAR WILL TRUST - HOW IT WORKS



TIP	Set up a "two year will" trust to minimise the IHT payable on your death		
SAVE	£100,000's	**EASE OF USE**	Complex
CONSIDER	This is a useful option when you make a high value of PETs.		
What you need to do	Take legal advice		

20.16.4 Discounted Gift Trusts

Discounted gift trusts are designed for people who do not need access to their capital and want to pass it to their heirs free from IHT. But they also want to retain the right to draw a regular income.

They work as follows:

- You make a gift into a single-premium insurance bond for your children, fixing how much income you draw until your death.

- If you survive for seven years, the bond does not count as part of your estate. Your heirs keep any growth in the bond as well as what remains of your investment.

- Even if you die within seven years, your heirs will get a discount on the IHT because your right to draw an income from the gift reduces its value. The extent of the reduction depends on your age, health, gender and level of income. For example, if you are male, 70, and draw 5% a year from a scheme, about 45% of the trust's assets could fall out of the estate as soon as a gift is made.

Making a simple gift and continuing to receive an income from it is a gift with reservation and is ineffective for inheritance tax purposes. A Discounted Gift Trust allows you to get an income from your capital whilst immediately putting some of your capital out of the reach of the taxman!

The 2 disadvantages to this type of arrangement are that;

- you lose all access to your capital, and

- the value passed on to your beneficiaries is dependent on investment returns which are outside your control.

TIP	If you require income from your assets, consider setting up a Discretionary Gift trust		
SAVE	£100,000's	**EASE OF USE**	Complex
What you need to do	Take advice from an IFA		

20.16.5 A Gift and Loan Trust

For those who want to try trusts, but also want access to their capital, a gift and loan trust is a good halfway house for tackling IHT.

Under this arrangement, a lump sum is put into a trust, partly by way of gift and mostly by way of loan, where it gets invested in a single Premium Bond.

The Trustees can withdraw up to 5% of the original investment per annum to make part repayments of the loan without a charge to Income Tax being incurred (tax free withdrawals). The amount of the loan outstanding at any time would remain in the Settlors estate but all future growth would be outside the estate.

When the investor dies the Bond pays out to the Trustees. This is free of Inheritance Tax as it is not part of the investors' estate. The Trustees pay the amount of loan outstanding back to the investors estate, where it is subject to Inheritance Tax and pays the balance to the beneficiaries of the Trust. This would be a chargeable event for Income Tax purposes.

Any growth in capital is therefore outside the estate for IHT, but on death, the original lump sum is returned to the estate and will form part of any IHT assessment. Before then, income may be taken from the trust and the original capital can be accessed at any time.

TIP	If you require income from your assets, and access to your capital, consider setting up a Gift and Loan Trust		
SAVE	£100,000's	**EASE OF USE**	Complex
What you need to do	Take advice from an IFA		

20.17 Inheritance Tax planning checklist

Among the 6 "Bonus" items that you received absolutely FREE with this Guide is a checklist of points for you to consider when you are deciding how you can reduce the Inheritance Tax that will be charged on your estate when you die. **Use it**.

TIP	Work through the checklist and act upon it		
SAVE	£1,000's	**EASE OF USE**	OK

The following points are aimed at Executors, those people whose job it is to distribute a deceased's estate in accordance with the wishes of the deceased.

20.18 Quick Succession Relief

When someone dies within 5 years of receiving a "chargeable transfer" from someone else, the IHT payable on their estate can be reduced by "Quick Succession Relief".

Remember, a "chargeable transfer" is a gift on which IHT has been paid.

The amount of the relief is calculated as follows;

$$\frac{\text{Net value of chargeable transfer}}{\text{Gross value of chargeable transfer (incl IHT)}} \times \text{IHT paid on chargeable transfer} \times \text{Percentage}$$

The percentage is defined by the period between receiving the transfer and the death of the transferee, as shown in Figure 23 below.

Figure 23: Quick Succession Relief

Period between transfer and death	%
Less than 1 year	100%
1 – 2	80%
2 – 3	60%
3 – 4	40%
4 – 5	20%
Over 5	0%

EXAMPLE

Sheila Richards died on 25 June 2004 leaving an estate of £275,000. Sheila had previously received a gift of £40,000 from her father on 2 February 2001. She paid tax of £16,000 on this gift following her father's death on 12 September 2001.

As Sheila died between 3 and 4 years after receiving the gift, the IHT on Sheila's estate will be reduced by Quick Succession Relief as follows;

$$\frac{24{,}000}{40{,}000} \times 16{,}000 \times 40\% = £3{,}840$$

The IHT chargeable on Sheila's estate is £4,800, being 40% of £12,000 (which is £275,000 less £263,000). However, only £960 of IHT is payable after deducting the Quick Succession Relief.

TIP	Claim quick succession relief		
SAVE	£1,000's	**EASE OF USE**	OK

20.19 Value gifts at market value on death

If;

- the value of a gift has reduced between the **time of the gift** and **the death of the donor**, and
- the gift was **not** “tangible movable property” with a life of less than 50 years (for example cars),

then the **lower value** may be used to calculate the IHT due on this gift.

If the recipient has sold the gift, then the **sale proceeds** may be used **if** this value is lower than the value of the gift when it was made, but the sale must have been an “arms length transaction” i.e. a freely negotiated sale to an unconnected person.

TIP	Value a gift at market value on the date of death if this is lower than the value on the date that the gift was made		
SAVE	£1,000’s	**EASE OF USE**	OK

20.20 Re-draft existing wills to make them more tax-efficient

If someone dies with a will that is not tax-efficient, it is possible to rewrite the will up to two years after the date of death to fix this. This involves a Deed of Variation.

TIP	Save IHT by re-drafting written wills		
SAVE	£1,000’s	**EASE OF USE**	OK
What you need to do	Take professional/legal advice		

21 OTHER TAXES

Everyone should read this Section

In this Section, you will learn;

- **How to reduce your Council Tax bill**
- **When you can avoid paying the full amount of Vehicle Excise Duty (car tax)**
- **When you can avoid paying the full amount for a TV licence**
- **How to cut the tax you pay on fuel**
- **How to reduce the excise duty you pay on cigarettes and alcohol**

21.1 Council Tax

You pay Council Tax on any property that you live in. This includes houses, flats, maisonettes, bungalows, mobile homes and houseboats.

Council Tax only applies to **domestic properties**, not commercial properties.

There is usually one yearly bill for each property (although this can be paid in monthly instalments) and this is usually payable by the occupier.

The standard council tax charge for a property is determined by three main factors;

- The **banding** of the house,
- The **number of occupiers** in the house, and
- Your **local authority.**

Lets look at each of these areas in turn.

21.1.1 Banding

Every property in England, Wales and Scotland is allocated a band, A to H, which is based on its value in **April 1991**.

New dwellings are also banded based on their value at 1st April 1991, had they existed at that time.

These bands are shown in Figure 24 below.

Figure 24: Council Tax Bands

BAND	RANGE OF VALUE
A	Up to 40,000
B	40,001 to 52,000
C	52,001 to 68,000
D	68,001 to 88,000
E	88,001 to 120,000
F	120,001 to 160,000
G	160,001 to 320,000
H	320,001 upwards

Note: The Government has stated that it will revalue and re-band all properties from 1st April 2007.

The Valuation Office Agency, which is a division of the Inland Revenue, is responsible for banding. If you want to appeal or query the banding of a property you must complete and send a 'Proposal to Alter the Valuation List' to your local Listing Officer. These forms are available from the Valuation Office Agency or from your Local Council.

However, there are very limited grounds for appeal against banding. They are:

- where there has been a **'material' change** in the value of the property,
- when you stop or start using part of a domestic property to **carry out a business**, or where the **proportion of business use** changes,
- where the Listing Officer has **altered the banding** but you did not ask that this should be done.

You must appeal **within six months** of becoming the Council Tax payer in respect of the property for the first time. If, however, the same appeal has already been made by a different Council Tax payer, and it has already been considered and decided by a Valuation Tribunal, you cannot make a further appeal on the same grounds.

TIP	If you think that your property is incorrectly banded, make an appeal to your Listing Officer		
SAVE	£100's	**EASE OF USE**	OK
What you need to do	Contact your Local Council and ask for a "Proposal to Alter the Valuation List" form. Complete the form and send it to your local Listing Officer (your Council will be able to tell you the address of this person).		

21.1.2 Number of Occupiers

The full Council Tax charge assumes that there are two or more adult occupiers. If there is only one adult occupier, a **25% discount** is awarded.

The following people are not counted as an occupier (and are "disregarded") for Council Tax purposes;

- aged 17 or under,
- living in the property temporarily and who have their home somewhere else,

- prisoners,
- in detention prior to deportation or under mental health legislation,
- defined as a severely mentally impaired person,
- full-time students on a qualifying course of education,
- a spouse or a dependant of a student and a non British Citizen who is not allowed under immigration rules, either to work in the UK or claim benefit,
- Student nurses/Project 2000 student nurses,
- young people on government training schemes, apprentices, or foreign language assistants,
- hospital patients who live in hospital,
- living in a residential care home, nursing home, or mental nursing home where they receive care or treatment,
- living in a hostel which provides care or treatment because of a person's old age, physical or mental disability, past or present alcohol or drug dependence or past or present mental illness and in England a bail or probation hostel,
- carers,
- care workers,
- staying in a hostel or night shelter, for example, in a Salvation Army or Church Army hostel,
- school or college leavers still aged under 20 who have left school or college after 30 April. They will be disregarded until 1 November of the same year whether or not they take up employment,
- aged 18 and someone is entitled to child benefit for them. This includes a school or college leaver in remunerative work, or a person in local authority care,
- members of a religious community,
- members of visiting armed forces and their dependants.

When determining the number of occupiers of a property, these people are ignored.

ILLUSTRATION

A house occupied by two adults, one of whom is "disregarded", will qualify for the 25% single occupier discount (as it will be treated as a house with only one occupier).

TIP	Get 25% off your Council Tax bill if, excluding "disregarded people", there is only one occupier of your home		
SAVE	£100's	**EASE OF USE**	OK
What you need to do	Call the Council Tax department of your local Council and inform them of the "single occupancy" of your property.		

21.1.3 Discounts and exemptions

There are a number of situations in which the occupier of the property may be able to claim discounts to, or exemptions from, the standard charge. These are listed below.

Second homes

These are defined as **furnished** domestic properties that are no-one's sole or main residence. From 1st April 2004, the standard council tax charge has been reduced by 10% for second homes (previously 50%).

TIP	Get 10% off your Council Tax bill if you own a house that is not your main home.		
SAVE	£100’s	**EASE OF USE**	OK
What you need to do	Call the Council Tax department of the Local Council and inform them that a house is not your main home.		

Empty properties

These are defined as **unfurnished** domestic properties that are no-one's sole or main residence. These are exempt from Council Tax **for a maximum of six months**. After this period, the full amount of Council Tax is payable[30].

If an unoccupied property becomes occupied for less than six weeks it is treated as being continuously unoccupied.

TIP	Get a 6 month exemption from Council Tax for an empty property.		
SAVE	£100’s	**EASE OF USE**	OK
What you need to do	Call the Council Tax department of your Local Council and inform them that your property is empty.		

You only get one six-month exemption per property. If the property is still unoccupied at the end of this six month period, you should therefore move in some furniture, and claim the 10% discount that is available on “second homes” – see above.

TIP	Put some furniture into an unfurnished property once you have claimed the six month Council Tax exemption, as this will entitle you to claim 10% discount on your Council Tax until such time as the property is occupied		
SAVE	£100’s	**EASE OF USE**	OK

Certain **unoccupied properties** are **exempt** from Council Tax for a period **longer than 6 months**;

- If you are undertaking major structural alterations or repairs **to make the property fit to live in**, the property will be exempt from Council Tax for a maximum of **12 months** from when the works commence. Updating and refurbishment is not enough so, if you buy a house and decide to fit a new kitchen and bathroom, you will **not** qualify for an exemption **unless** you can show that the property was not fit to live in before the work started.

TIP	Property developers can claim an exemption from Council Tax for up to 18 months		
SAVE	£100’s	**EASE OF USE**	Simple
What you need to do	Claim your standard “unoccupied property “exemption for the first 6 months of ownership. Then start work on the property and claim a further 12 month’s “renovation exemption” as described above.		

[30] Unless you are undertaking major renovation of the property – see later.

- If you go into **hospital or a care home,** permanently leaving your home unoccupied, it will be exempt from Council Tax from the date that you go into hospital or the care home,

- If you leave your home unoccupied and move to another home in order to **receive care**, **or provide care to someone else**, your home will be exempt from Council Tax from the date that you move out,

- If the empty property is part of another dwelling and, under planning regulations, it cannot be let separately from the other dwelling (e.g. a Granny Annex), then the empty property is exempt from Council Tax.

TIP	Claim exemption from Council Tax for a period of more than 6 months		
SAVE	£100's	**EASE OF USE**	Simple
What you need to do	Confirm your compliance with the exceptions listed above Call the Council Tax department of your Local Council and tell them about your circumstances.		

Occupied properties

Certain **occupied properties** are **exempt from Council Tax**. These include;

- **Halls of residence** at Universities or Colleges,

- Dwellings occupied **only** by **students, or by school or college leavers**,

  A student is someone attending a "Qualifying Course" at a "Prescribed Educational Establishment". If this might apply to you, ask your Local Council for a definition of these terms

  A school or college leaver is a person aged 18 to 19 who left school or college between 1st May and 31st October. If the school or college leaver becomes a student by 1st November, the exemption will continue.

- **Armed Force Accommodation,**

- Any property **owned by the M.O.D**. for armed forces accommodation,

- Dwellings occupied **only by persons under 18,**

- Dwellings occupied **only by the Severely Mentally Impaired** (SMI) or a mix of SMI and Students. A registered medical practitioner must certify that a person is SMI in order for that person to be able to claim this exemption,

- Dwellings which are owned by, and are the main residence of, **a person with diplomatic privilege or immunity,**

- **Annexes occupied by dependent relatives,**

  This exemption applies to dwellings that are occupied, but are annexed to another dwelling, where the occupier of the annex is a **dependent relative** of the person who is resident in the other dwelling. A dependent relative must be over 65, or Severely Mentally Impaired, or substantially and permanently physically disabled.

TIP	Claim exemption from Council Tax on certain **occupied** properties		
SAVE	£100's	**EASE OF USE**	Simple
What you need to do	Confirm compliance with the exceptions listed above Call the Council Tax department of your Local Council and tell them about your circumstances.		

Disabled occupier

If you are **disabled**, **or** you have a disabled person **living permanently with you**, you may get a reduction in your Council Tax bill.

To qualify for the "disabled occupier" reduction, the property must be the **sole or main residence** of a person who is **permanently and substantially disabled <u>and</u>;**

- there must be a room, other than a kitchen, bathroom or lavatory, in the property which is **mainly used** for **meeting the needs of the disabled person**, **or**

- there must be a **second kitchen or bathroom** which is used for **meeting the needs of the disabled person** (a second lavatory cannot qualify), **or**

- the disabled person must need to use a wheelchair indoors and there must be space for him/her to do so.

The reduction is awarded by treating the property as if it was in the Council Tax band immediately below the actual band. So a Band B property is treated as if it is in Band A. In the case of a Band A property, a reduction of one sixth in the base charge is allowed.

TIP	Get a reduction in Council Tax for disabled occupiers		
SAVE	£100's	**EASE OF USE**	Simple
What you need to do	Confirm compliance with the exceptions listed above Call the Council Tax department of your Local Council and tell them about your circumstances.		

21.2 Vehicle Excise Duty

A vehicle license (or tax disc) shows that you have paid the required Vehicle Excise Duty ("VED") for your vehicle.

Your vehicle must **<u>always</u>** be licensed **unless** you stop using it **and** you do not keep it on a public road.

If you have licensed your vehicle and you then stop using it, you can claim a refund for the unused part of the VED by filling in a Form V14, which you can obtain from your local Post Office. If you have lost your original licence disk, you will need to fill in a Form V33.

Refunds are only made for complete months still to run and a refund cannot be backdated.

TIP	Get a refund for VED if you are not using your vehicle		
SAVE	£10's	**EASE OF USE**	OK
What you need to do	Fill in Form V14/V33, which you can get from your Post Office		

You can claim **<u>exemption</u> from paying VED** if you receive one of the following benefits;

- the higher rate of the mobility component of Disability Living Allowance, and

- War Pensioners Mobility Supplement

To obtain this exemption, you need to produce a certificate that confirms that you are receiving these benefits.

If you receive the higher rate of the mobility component of Disability Living Allowance, you should obtain certificate DLA 404 from;

Disability and Carer Benefits Directorate, Disability and Carers Service, Warbreck House
Warbreck Hill, Blackpool,FY2 0YE.
Tel: 0845 7123456

If you receive War Pensioners Mobility Supplement, you should obtain certificate WPA 442 from;

Veterans Agency, Norcross, Blackpool,FY5 3WP
Tel: 0800 1692277

TIP	Claim disabled exemption from paying VED		
SAVE	£100	**EASE OF USE**	Simple
What you need to do	Get an exemptions certificate from the relevant agency and then send it, along with a vehicle license application form (V10), a vehicle registration document (V5), a valid MOT certificate and a valid certificate of insurance to a DVLA local office. The DVLA Local Office will issue the disabled licence disc and pass all papers to DVLA Swansea. You will then receive a new Registration Certificate showing your new taxation class.		

If you start to receive the higher rate of the mobility component of Disability Living Allowance or War Pensioners Mobility Supplement, you can **claim a refund** for any VED that you have paid that relates to any future period. You can apply for this refund by completing and sending in a Form V14 (which you can get from our local Post Office).

TIP	Claim a refund for VED		
SAVE	£10's	**EASE OF USE**	Simple
What you need to do	Complete and send in Form V14 to your local DVLA office.		

21.2.1 Fuel efficient cars

You can save VED by running a car with a lower CO2 emissions level and/or that uses alternative fuel (such as electricity or LPG), although the tax savings aren't large. See Figure 25 below.

Figure 25: Rates of VED for cars registered on or after 1st March 2001

		Diesel Car		**Petrol Car**		**Alternative Fuel Car**	
Bands	**CO_2 Emission Figure (g/km)**	**12 months £**	**6 months £**	**12 months £**	**6 months £**	**12 months £**	**6 months £**
A	Up to 100	0.00	-	0.00	-	0.00	-
B	101 to 120	50.00	-	40.00	-	30.00	-
C	121 - 150	110.00	60.50	100.00	55.00	90.00	49.50
D	151 - 165	135.00	74.25	125.00	68.75	115.00	63.25
E	166 - 185	160.00	88.00	150.00	82.50	140.00	77.00
F	Over 185	195.00	107.25	190.00	104.50	180.00	99.00
Vehicles registered on or after 23rd March 2006							
G	Over 225	215.00	118.25	210.00	115.50	200.00	110.00

TIP	Save VED by running a fuel efficient car		
SAVE	£10's	**EASE OF USE**	Simple

21.3 TV Licence

A TV licence is required for every household. A colour licence currently costs £131.50 a year and a black and white licence costs £44.00.

21.3.1 Age concession

People aged 75 and over are entitled to a **free** Television Licence. **Interim licences** are available for people aged 74, but who will be 75 during their next licence period.

You only need to apply for a free licence once, and the licence is then automatically renewed annually.

If you have an elderly relative living with you, put the licence in their name and you can have a free TV licence for the household.

TIP	Get your TV licence free		
SAVE	£131.50	**EASE OF USE**	Simple
What you need to do	Complete the application form that you will receive with your TV licence reminder. You will then receive a special short-term licence to take you up to your 75^{th} birthday, and your free licence after that. If you do not get an application form with your TV licence reminder, call the TV licensing helpline on 0845 603 6999.		

21.3.2 Blind concession

All children and adults who are registered blind can obtain a **50% discount** on the cost of their TV licence.

In order to claim this discount, you need to send the original copy of your local authority registration document to the TV Licensing Authority. You only have to show this document once, when you apply for your first concessionary licence.

A registered blind person who has bought a full fee licence can, upon showing their local authority registration document, apply at any time during the licence year for a refund of 50%.

TIP	If you are registered blind, get 50% off the cost of your TV licence		
SAVE	£10's	**EASE OF USE**	Simple
What you need to do	You will need to send a copy of your local authority registration document to the TV licensing authority.		

Refunds for previous years

Refunds are available for previous years, backdated as far back as 1^{st} April 2000.

So, if you have not claimed the 50% concession in previous years **and** you can prove that you had a TV licence **and** you were registered blind for this prior period, you are entitled to a backdated refund of 50% of the cost of your TV licences for this period.

TIP	Claim a refund if you have paid the full cost of the TV licence in previous years		
SAVE	£10's	**EASE OF USE**	Simple
What you need to do	Send the proof of the fact that you had a full TV licence and you were registered blind to the TV Licensing authority.		

Second homes

You can hold a blind concessionary TV licence for **any other homes** you may have, i.e. a weekend cottage or a relative's house where you stay on a regular basis. However, the licence must be in your name. You are entitled to get a 50% reduction on **every TV licence** you hold, not just for the one that relates to your main home.

TIP	If you are registered blind, get 50% off the cost of the TV licence for all homes in which you stay		
SAVE	£10's	**EASE OF USE**	Simple
What you need to do	Send the proof of the fact that you had a full TV licence and you were registered blind to the TV Licensing authority.		

21.3.3 Satellite TV/Internet TV

Current guidance is that you need to have a TV licence **even if** the only TV that you watch is;

- satellite TV from a place in the UK (e.g. Sky);
- on your computer.

You **do not** have to have a TV licence if you only use your TV to watch videos and DVDs.

TIP	Don't get a TV licence if you don't watch "live" broadcasts		
SAVE	£10's	**EASE OF USE**	Simple

21.3.4 Students/Tenants

If you live in halls of residence and you use a TV **in your own room**, you need to have your own separate TV licence.

You also need your own TV licence if you are sharing a house with other students, you use a TV in your room, **and** your room is a separately occupied place (a separate tenancy agreement would normally indicate that this is the case).

However, only one TV licence is required if;

- you have a separate tenancy agreement **but a television is only being used in a communal area, or**
- you are sharing a house with other students and you use a TV in your own room **but the house can be treated as one place shared by all** (a ***joint*** tenancy agreement would usually be evidence that the house is a single licensable place for this purpose).

TIP	If you share a house under a joint tenancy agreement, only buy one TV licence		
SAVE	£100	**EASE OF USE**	Simple

21.3.5 Lodgers

As a lodger, you'll need your own TV Licence if you have a television in your bedroom **unless;**

- you are a member of the family; **or**

- you live in the same household due to your relationship (e.g. common law relationships) or as a necessary part of your employment (e.g. au pairs, housekeepers etc).

These exceptions **do not cover** self-contained accommodation, such as separate flats or annexes, where a separate licence is required.

TIP	If you are living in a household because of your job or family relationships, you do not need to get a separate TV licence		
SAVE	£100	**EASE OF USE**	Simple

21.3.6 TV on the move

The TV Licence for your main address will cover any TV used in a touring caravan, vehicle or boat, or any televisions operated by their own internal batteries.

TIP	You do not need a TV licence for TVs used in “mobile” accommodation		
SAVE	£100	**EASE OF USE**	Simple

21.3.7 Second homes

If you use a TV in **a second home** such as a cottage, flat, bungalow, or any other permanent structure, you are required to have a separate TV Licence.

If you, or any other person, uses a TV in your static caravan or mobile home and another is being used in your main home **at the same time**, you'll need a separate TV Licence. However, if a TV isn't being used in your static caravan or mobile home at the same time as in your home, you don't need a separate TV Licence.

TIP	You do not need a separate TV licence for a “mobile” home, if no-one will be watching TV in your main home at the same time		
SAVE	£100	**EASE OF USE**	Simple

21.4 Fuel tax

21.4.1 Liquid Petroleum Gas

You can save tax (and reduce your other running costs) by converting your car to run on Liquid Petroleum Gas (LPG).

LPG is gradually becoming more popular. Italy currently has over one million LPG vehicles on the road. In the Netherlands, North America and Mexico there are around half a million such vehicles.

It typically costs around £1,000 to £1,500 to convert a petrol car to run on LPG, but there are **significant benefits;**

- LPG is **half the cost** of conventional petrol or diesel,

- While tax on petrol increases yearly, LPG duty has fallen 73% in the past seven years and the Treasury has pledged a further three-year tax freeze on LPG duties,

- Your road fund licence (or "vehicle excise duty") will be lower (see Figure 25), and

- If your car is provided by your company, you will pay less income tax as the taxable car benefit is reduced for LPG cars (see 7.9).

Surveys have shown that you can save **up to 40%** of your car's running costs by using LPG. On a typical dual-fuel vehicle doing 25,000 miles, that works out to an annual saving of about **£1,400.** Most of this saving comes from reduced fuel duties.

TIP	You can save significant amounts of tax converting your car to run on LPG		
SAVE	£1,000's	**EASE OF USE**	OK

21.5 Excise Duty

21.5.1 Cigarettes, cigars and tobacco

Over 85% of the UK retail price of a pack of cigarettes is tax – and most of this is excise duty.

Under EU regulations, you may buy tobacco products abroad **for your own personal consumption in the UK <u>without</u>** paying any further tax in the UK or breaking any import regulations.

As overseas governments charge a much lower level of duty on tobacco and related products than our own government, the price of cigarettes, cigars and tobacco is generally much cheaper in other EU countries than it is in the UK. **You will save money and tax by buying your tobacco products from overseas.**

The best way of doing this is by making a day-trip to France, or by picking up goods while you are away on holiday. At present, the UK guideline is that anything up to **3,200 cigarettes or 3 kg of smoking tobacco per adult traveller** will be considered to be for "personal use", although there will be exceptions. For example;

- A traveller with amounts over the guidelines could be allowed through if they can ***prove*** it is for personal consumption,

- Amounts below the guidelines could lead to enforcement action if, for example, the same person was coming through several times a week in an attempt to build up commercial levels of stock.

An alternative to a day-trip is to buy through an internet site whose operations are based overseas. These sites include www.yespeedy.com, www.esmokes.com and www.smokeandpayless.com.

Two particular words of warning if you are considering buying from these sites;

Firstly, **always** be careful when buying over the internet.

With this in mind, we suggest that you always conduct your own checks of the organisation before buying from them and test them with a small order first. Look for sites with contact telephone numbers (that are answered by a human being!) and call them before ordering.

Secondly, if your purchases are posted to you, the seller is required to pay the VAT and UK customs duty **before** they are received in the UK. If the seller has not paid these taxes, the goods may be seized by the Customs & Excise. In practice, however, small quantities of tobacco *are* allowed in to the UK by post **without payment of duty**.

Figure 26 shows the generally accepted level of posted goods that will be allowed in to the UK free of duty.

Figure 26: Quantity of tobacco that can be received by post free of duty

Products	Maximum quantity
Cigarettes	200
Cigarillos	100
Cigars	50
Tobacco	250g

TIP	Save excise duty by buying cigarettes from overseas		
SAVE	£1,000's	**EASE OF USE**	Simple
CONSIDER	It is best to buy whilst on an overseas trip to an EU country, although you can buy small quantities over the internet and have them posted to you tax-free. **Always** be wary of giving your credit card details to a person or company that you don't know.		

21.5.2 Alcohol

Under the same UK import guidelines referred in 21.5.1 above, you are allowed to bring the following quantities of **alcohol** into the UK from another EU country for your own personal consumption **without paying customs and excise duties**;

Products	Maximum Quantity
Wine	90 litres
Beer	110 litres
Spirits	10 litres

This only applies to people who are returning to the UK **from EU countries** - when travelling from a country outside the EU, you are entitled to a much-reduced allowance of 2 litres of table wine and 1 litre of spirits.

TIP	Save excise duty by buying alcohol from other EU countries		
SAVE	£1,000's	**EASE OF USE**	Simple
CONSIDER	As with tobacco, it is best to bring back alcohol from overseas trips, rather than buying over the internet.		

22 OTHER ALLOWANCES AND RELIEFS

Everyone should read this Section.

In this Section, you will learn;

- **How you can claim tax allowances that the Government have abolished**
- **How to get a tax deduction for maintenance payments**
- **If you are eligible to claim blind persons allowance**

22.1 Blind persons allowance

This allowance is available to all people who are registered as blind with a local authority.

However, you can claim this allowance for the tax year ***before*** you were registered **<u>if</u>** you have evidence of your blindness, such as an ophthalmologist's certificate, dated before the end of that previous tax year.

ILLUSTRATION

If you were registered on 6th May 2006, but you have an ophthalmologist's certificate dated 12th March 2006, you will be able to claim the blind persons allowance for 2005/2006.

The Tax Return does not make it easy to claim this back-dated allowance, as you <u>must</u> put the date on which you were registered with your local authority in Box 16.1.

You therefore need to write to your Tax Office, including evidence of your blindness in the previous tax year, and claim your allowance for the prior tax year.

TIP	Back-date your blind person's allowance		
SAVE	£100's	**EASE OF USE**	Simple
What you need to do	Send off evidence of your blindness to your Tax Office and claim your allowance for the previous tax year		

22.2 Old allowances

You must claim allowances **within 6 years** of the 31st January in the tax year to which they relate. So, you can claim allowances that relate back to 2000/01 up until 31st January 2007.

This means that you are perfectly entitled to claim allowances that have been abolished!

These allowances include;

- Additional personal allowance (which might apply if you were a single parent before 6th April 2000),
- Widow's bereavement allowance (which might apply if your husband died before 6th April 2000),
- Married couples allowance (which might apply if you were married before 6th April 2000). From 6th April 2000, this allowance has only applied to elderly people – see 6.2,
- Children's tax credit, which might apply if you had a child under 16 living with you between 6th April 2001 and 5th April 2003 (it has now been replaced by Child Tax Credit).

If you have not claimed these allowances before, you can claim them now. If you are in any doubt about whether these apply to you, speak to your Tax Office or local enquiry centre.

TIP	Claim old allowances back to 2000/01, if you have not claimed them before		
SAVE	£1,000's	**EASE OF USE**	OK
What you need to do	Speak to your Tax Office or local enquiry centre		

22.3 Relief for Maintenance

If you or your ex-spouse was born **before 6th April 1935**, you can get tax relief on any **alimony or maintenance** that you pay, up to £2,350 in 2006/07 (and £2,280 in 2005/06).

You get relief at the rate of 10%, so your maximum tax saving in 2006/07 is £235.

In order to qualify for this relief;

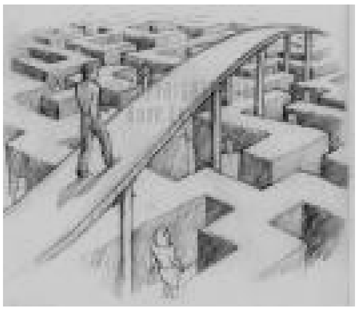
- You must make the payments under a **legally binding** agreement,
- The payments must be made for the maintenance of your **ex-spouse <u>or</u> any children aged under 21**. Payments made directly to your children do not count.

The tax relief **stops** on the date that your ex-spouse re-marries.

TIP	Claim a deduction for maintenance payments		
SAVE	£100's	**EASE OF USE**	OK
What you need to do	Fill in box 15.2 on your Tax Return.		

23 GENERAL ADVICE

Everyone should read this Section.



In this Section, you will learn;

- **How to find a Tax Advisor**
- **How to find a Financial Advisor**
- **How to find an Accountant**

23.1 Find a tax adviser

Here are some ways in which you could find a tax adviser to help your tax affairs and ;

- Speak to friends and colleagues. Who do they use? Can they recommend anyone?
- Speak to your bank manager or accountant. Who do they use? Can they recommend anyone?
- Look on the internet or in the local phone book, but make sure that you check up on the qualifications of any that you speak to. For example;
  - o someone with the designated letters 'ACA' (or 'FCA') is a Chartered Accountant,
  - o an 'ACCA' (or 'FCCA') is a Chartered Certified Accountant, and
  - o 'ATII' 'FTII' or 'CTA' are the designated letters of a Chartered Tax Adviser.

  If you are thinking about using an accountant (as opposed to a Chartered Tax Adviser) try to find out whether he or she specialises in tax, as **not all accountants are tax experts**. Conversely, a Chartered Tax Adviser may have little or no experience preparing accounts. Always check first if in doubt.

  Qualifications are not everything, but they are a very important consideration. There are many highly experienced tax advisers without formal qualifications, including some ex-Inland Revenue staff. However, using a non-qualified person involves more 'pot luck' than engaging a qualified tax adviser.

Whoever you find, you must make sure that they can provide you with advice in the areas that you require. Tax is a huge subject, consisting of a number of different areas (e.g. Income Tax, Corporation Tax, Capital Taxes and VAT), and some tax advisers have general knowledge in those areas, while others may specialise in a particular field.

As a guide;

- If you only need your Tax Return preparing once a year and/or your tax affairs are relatively straightforward, then you should look to find a tax adviser with **general tax knowledge** who is prepared to work on a "**fixed fee**" basis,
- If you are self-employed, or have a limited company needing accounts preparation, then you may prefer to choose a **qualified accountant with sound tax knowledge**,
- If your affairs are complex and/or you need tax planning advice, **a qualified and experienced tax adviser will probably be the best option**.

In this respect;

- If you are looking for complex advice in a specific area (e.g. estate planning), you should look to find a **specialist in that field**,

- If your tax affairs are complicated and encompass a number of different areas, it may be better to engage a **firm** with specialists in each those areas, rather than relying upon a single adviser.

You should be aware that tax advisers are now required to **register** certain tax-planning schemes with the Inland Revenue.

So, if you are considering a complex tax-planning scheme that has been recommended to you by your adviser, ask your adviser whether it is likely to be challenged by the Revenue and whether it has a **registration number.**

TIP	Ask your adviser whether complex tax planning schemes have been registered with the Revenue		
SAVE	£1000's	**EASE OF USE**	Simple

23.2 Paying a tax adviser

So, how much will it cost you to get specialist tax advice? Well, it all depends……

Unless you are going for a 'fixed fee' service, tax advisers will normally charge on the basis of the time that they spend on a particular task. Their rate per hour will reflect a number of factors, such as their qualifications and experience, and possibly other criteria as well, such as the size and location of the firm that they work for.

Whoever you use;

- you should try to agree **fees in advance** for a particular piece of work,

- **don't be afraid** to ask for an estimate of fees, and also what rates per hour will apply, and

- shop around and compare rates and costs for 2 or 3 advisers. However, don't always make your selection based on the price. Your impressions of the adviser are just as important as cost!

23.3 Find a Financial Adviser

It is very important that you find a good "Independent Financial Adviser" (IFA).

IFAs are, as their name suggests, independent - they are not linked to any company that provides financial products and services, so they can search the whole market to find the best product for you.

IFAs are **bound by rules** issued by the Financial Services Authority, which obliges them to provide advice **most suited to your personal requirements** and your attitude to risk. When financial products are recommended they must take into account the benefits provided, charges, flexibility, service and the financial strength of the company providing the product.

All IFAs must be **authorised and regulated** by the Financial Services Authority and are obliged to offer what is termed 'suitable advice'. This means that they have to gain a full understanding of your circumstances and requirements before helping to choose any financial products. They will ask you to check a document that they have prepared that sets out your personal and financial information **before they give you any advice,** to double-check that they really have understood what you have told them.

In addition, when recommending a product, all IFAs have to provide **written reasons why they think that it is right for you** - again to make sure that you are fully informed before committing yourself to anything.

Here are some ways of finding an IFA to help you with your tax affairs;

- Speak to friends and colleagues. Who do they use? Can they recommend anyone?
- Speak to your bank manager or accountant. Who do they use? Can they recommend anyone?
- Call IFA Promotions on 0800 085 3250. “IFAP” are an independent organisation and they can provide you with advisers by geographical area and expertise,
- Log on to the Personal Finance Society website (www.thepfs.org) and you can search for advisers by geographical area and expertise,
- Look on the internet or in the local phone book, but make sure that you check up on the qualifications of any that you speak to (see below).

Generally it's a good idea to ring at least three advisers. Things to check before deciding which one suits you best include:

- How long have you been in business? You may feel more comfortable with someone with several years' experience.
- How do you charge – fixed fee, commission or a combination of these, and how much is the advice likely to cost?

  Commission. Advisers may receive commission from the company that provides the product that they sell. **You** will ultimately pay this commission through the charges that you pay on this product.

  Fees. Many IFAs charge fees for advice **instead of** receiving commission on the product that they sell you. These fees will vary according to the type of advice you want and the level of expertise you need, but a rough guide is in the region of £75 to £150 per hour. Fee-based advisers will often give you the first half hour of advice free.

  Combination of both. IFAs who charge fees will often offer to combine the fees with a commission service. With this arrangement, the cost of the advice is worked out on a fee basis, but the bill is settled out of the commission that they receive from the products that you buy. If the commission is less than the bill, you will have to make good the difference. If the commission comes to more than the bill, the IFA will either pay you the difference or invest it for you in whatever product you have bought.

  Paying by fee has the advantage that you can see exactly how much the advice is costing. Plus, there's no risk that the adviser will recommend a product with a high level of commission rather than the one which suits your needs best.

  However you pay;

  - make sure that you know **how much the advice is costing you**, and
  - don’t be afraid to **negotiate** on the cost of the advice.

- What qualifications do you have? All advisers must pass an exam called the Financial Planning Certificate (FPC), so they should at least have this, but there are relevant professional qualifications they might have as well. The Advanced Financial Planning Certificate (AFPC), The Associateship of the Chartered Institute of Insurance (ACII), the Certified Financial Planner (CFP) and the Institute of Chartered Accountants (ACA or FCA) are four to look out for. If possible, you should choose an adviser with one of these further qualifications.
- Do you have any particular areas of expertise? Some areas of financial planning, such as long-term care and post-retirement planning, should only be tackled by advisers with the necessary expertise.

Once you have found an adviser, you should call the Financial Services Authority on 0845 606 1234 and check that they are authorised.

When you meet with your selected IFA, you **must** provide them with a complete picture of your finances. Don't keep any skeletons in the closet! The IFA will not be able to give you the most appropriate financial advice if you only provide them with half the picture.

23.4 Find an Accountant

If you have a business, you will need to get a set of accounts prepared for each and every accounting period;

- If you operate your business through a limited company, you will need to file these accounts at Companies House within 10 months of your accounting year-end (assuming that your company is a private company),

- If you operate your business as a sole trader or a partnership, you will need to get these accounts prepared so that you can complete your Tax Return.

If you operate through a limited company, you will **also** need to have your accounts audited **unless** your company is exempt by virtue of being a "small company".

For accounting years ending after 30th March 2004, a small company is defined, in general terms, as one;

- that meets two out of the following three criteria;
    - turnover of not more than £5.6 million
    - a balance sheet total of not more than £2.8 million
    - an average number of employees of 50 or less.
- **and** is not;
    - a public limited company; or
    - a parent company (unless the "group" meets 2 out of the 3 the "small company" criteria listed above)

If you need to have your accounts audited, you will need to find an individual or, more likely, a firm that is a "Registered Auditor".

If you just need to have some accounts prepared, you should look for a qualified Chartered Accountant.

Here are some ways of finding a Chartered Accountant;

- Speak to friends and colleagues. Who do they use? Can they recommend anyone?

- Look on the internet or in the local phone book, but make sure that you check up on the qualifications of any accountants that you speak to. Look back to the start of this Section to remind yourself of the letters that designate a Chartered Accountant. Look for the logos of the Institute of Chartered Accountants in England and Wales on their letterhead;

THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND & WALES

- **Log on to the "Resource Directory" on our website**, where we have published the names and telephone numbers of a few accountants, such as Abacus (01608 650945), that have been **recommended** to us on several occasions by our readers.

23.5 Paying an accountant

The advice that we gave for "paying a tax advisor" holds good here.

- Try to agree a fixed fee in advance for a particular piece of work
- If you cannot get a fixed price quotation, ask what charge-out rates they will apply
- Shop around and compare rates and fees from 3 or more Accountants. However, don't always make your selection based on the price. Your impressions of the Accountant are just as important as cost!

24 FINAL WORDS

We will finish off by re-iterating a few very important points that we made a long time ago in the Introduction to this book.

24.1 Stay up to date

Firstly, it is very important that you stay up to date with the tax rules, as future changes may invalidate the tax tips that we have described in this book.

24.2 Any Questions?

Secondly, we regret to say that we do not have sufficient staff to be able to answer tax queries or provide tax advice over the telephone or over the internet – our contact telephone number email address are for orders and sales only.

We have made every effort to ensure that the Guide is self-explanatory and easy to understand but, if you do have a tax-related query arising from something that you have read in this Guide, we recommend that you speak directly with a tax advisor. In Section 23 of this Guide, we have provided advice on how you can find a tax advisor.

24.3 Your Feedback

Thirdly, we would really appreciate getting feedback from you about this book. So much so, in fact, that we will give you our **"Beginner's Guide to Pensions**", **ABSOLUTELY FREE**, if you tell us;

- what you think about the book, and/or,
- how much tax you have saved from using tips described in the book, and/or,
- new tax tips for inclusion in the next edition of "Cut Your Tax Bill".

All you need to do is click on the "About Us" link on the home page of our website, then click on "Feedback" and then follow the instructions. We will be delighted to "name check" you in future editions if your suggested tips are published.

24.4 Conclusion

We hope that you have found many practical ways in which you can reduce the tax that you pay and that you have found this book a stimulating and enjoyable read.

25 DETAILED CONTENTS

APPENDIX 1

Inland Revenue Helplines

Topic	Number
Non-Residents Income tax National insurance	 0845 070 0040 0845 915 4811
Charitable giving (including Gift Aid)	0845 302 0203
Construction Industry scheme Contractors Sub-contractors	 0845 733 5588 0845 300 0581
Employers New employers Established employers	 0845 607 0143 0845 714 3143
ISAs	0845 606 1701
Inheritance Tax	0845 302 0900
National Insurance Registrations Self employed Other queries	 0845 915 7006 0845 915 4655 0191 213 5000
Self-employed	0845 915 4515
Self-assessment General Orderline for leaflets and forms Internet services Minicom	 0845 900 0444 0845 900 0404 0845 605 5999 0845 900 0404
Stamp duty	0845 603 0135
Tax Confidential	0845 608 6000
Taxback	0845 077 6543
Tax Credits Great Britain Northern Ireland	 0845 300 3900 0845 603 2000
Welsh speakers	0845 302 1489

APPENDIX 2

Trusts

What is a Trust?

Essentially, a Trust is an arrangement whereby one person (“**the Settlor**”), transfers assets to another person, whom he has appointed (“**the Trustee**”), and instructs the Trustee to use those assets, and any other assets which may subsequently be added to them, strictly for the benefit of other persons (“**the Beneficiaries**”).

The Settlor may be, and often is, a Beneficiary and usually the other Beneficiaries will be members of the Settlor’s family. They can however be any persons nominated by the Settlor.

The Settlor’s instructions are contained in a written document, which is called the “**Trust Deed**”. The Deed ensures that the Settlor, the Trustee and the Beneficiaries know their respective rights and duties.

The Trustee must **always** act in the best interests of the Beneficiaries. The Trustee therefore has the **legal ownership** and **control** of the assets but he or she **cannot benefit from them** - the benefit is for the Beneficiaries only.

In simple terms, then, a Trust involves one person giving assets to a second person, who then has to use those assets for the benefit of, and eventually give those assets to, a third person (or persons) whose identity is determined by the first person.

The most common forms of trust are;

Interest in Possession Trust

Under this type of trust, the beneficiaries are **entitled** to the income of the trust **as of right**.

Any income earned by the assets in the trust (less the expenses of running the trust) **must** be distributed to the beneficiaries.

The capital of the trust **may** be distributed to the same beneficiaries dependent upon them reaching a certain age, or to other beneficiaries when the income beneficiaries have died.

Discretionary Trust

Under this type of trust, the beneficiaries are **not entitled** to receive any income as of right.

The trustees are given wide powers to distribute income and/or capital in such proportions and at such times as they see fit, subject to any specific instructions given to them in the Trust Deed.

Accumulation and Maintenance Trust

This is a hybrid of the previous two types of trust.

To qualify as an A&M trust, it must meet certain conditions;

- It must be for the benefit of one or more persons under the age of 25,
- The beneficiaries must become entitled to the capital at age 25, or to the income as of right by that age,
- All beneficiaries must have the same grandparent or it must not exist for more than 25 years.

No beneficiary can have the right to income at the outset – the distribution of the trust’s income must be discretionary in nature.

The trustees can pay out income or capital for the maintenance, education or other benefit of the beneficiaries.

If income is not paid out, the income is accumulated (added to capital).

This type of trust allows great flexibility and receives favourable tax treatment.

Tax Treatment

The 2006 Budget proposed major changes to the way in which some Trusts are taxed.

As these proposals have not yet been approved by the Government, (and there is therefore a chance that the proposed rules will change), we explain below both the tax treatment of trusts before and after the 2006 Budget.

Discretionary Trusts

The tax treatment of Discretionary Trusts has remained unchanged after the 2006 Budget.

Gifts **to** a Discretionary Trust are treated as **Chargeable Transfers** for IHT (see Section 20 for further explanation). As such, IHT will be payable at the lifetime rate (20%) to the extent that the value of this gift makes the "running total" of chargeable transfers exceed the nil rate band threshold (see section on Inheritance Tax for further explanation).

Such gifts will also trigger a Capital Gains Tax liability as this is a disposal for tax purposes. However, you can elect to "holdover" a gain, which will defer the CGT charge until the asset is sold by the Trustees.

The Trustees pay tax of 25% on dividends and 34% on other income and capital gains.

Non and starting rate taxpayers can recover tax paid by the Trustees on non-dividend income (the tax credit on dividends is not recoverable). Higher rate taxpayers will have to pay an additional 6% tax.

The Trust also has to pay;

- a periodic charge of 6% of the value of trust assets over the IHT threshold every 10 years; and
- an exit charge proportionate to the periodic charge when the funds are taken out of the trust between 10 year anniversaries.

Interest in Possession Trusts

Pre 2006 Budget

Gifts **to** an IIP Trust are treated as **Potentially Exempt Transfers** (see Section 20 for further explanation) for Inheritance Tax ("IHT") purposes.

Such gifts will also trigger a Capital Gains Tax liability as this is a disposal for tax purposes.

On the death of a beneficiary of an IIP trust, the entire value of the IIP trust is added to his estate and is charged to Inheritance Tax.

The Trustees pay tax on the income of the Trust at the basic rate (dividends 10%, interest 20% and other income 22%).

The beneficiary is liable to pay tax **whether the income is paid out to him/her or not**. Non and starting rate taxpayers can recover tax paid by the Trustees on non-dividend income (the tax credit on dividends is not recoverable). Higher rate taxpayers will have to pay tax that "tops up" the tax already paid (to 32.5% dividends and 40% other).

The Trustees pay tax on capital gains at 34%.

Post 2006 Budget

IIP trusts are treated like Discretionary Trusts (see above), **unless**;

- the trust is set up for a disabled person, or

- the trust is created on death by a parent for a minor child who becomes absolutely entitled at eighteen years, or

- the trust is created on death for one life tenant "in order of time" with absolute vesting thereafter,

in which case the trust will be taxed as before the 2006 Budget.

With regard to interest in possession trusts existing on 22 March 2006, the pre-2006 Budget tax rules will run on until the interest in possession in existence at 22 March 2006 comes to an end. If the interest comes to an end and the property remains in trust, this will be treated as the creation of a new settlement and the new tax rules will apply thereafter.

Accumulation and Maintenance Trusts

Pre 2006 Budget

Gifts **to** an A&M trust are treated as **Potentially Exempt Transfers** for IHT purposes (see Section 20 for further explanation).

Such gifts will trigger a Capital Gains Tax liability as they are treated as a disposal for tax purposes.

If you set up an A&M Trust for your children, you will not be taxed on any income earned in the Trust by the Trust's investments **as long as;**

- the only amounts paid to them are out of the income of the Trust; and

- the Trustees agree that it is for the child's benefit (maintenance, education etc).

If this is not the case, and income is distributed for other reasons, it will be taxed as if it was your income if;

- The beneficiaries are under the age of 18; and

- The value of the income that is distributed, together with any other income provided by the parent, exceeds more than £100 in any tax year.

The Trust will pay tax at 25% on dividends and 34% on other income (which is a saving of 6% compared to higher rate taxpayers). It will also pay Capital Gains Tax of 34% on the gain made on any asset disposals.

If income is released to the beneficiaries at the trustees' discretion (i.e. prior to them becoming entitled to receive it), it will carry a tax credit of 34%.

The beneficiaries will therefore be able to reclaim this tax from the Revenue if they are not taxpayers when they receive the income. If they pay tax at the higher rate, currently 40%, they will get credit for the 34% already paid. They will therefore only be required to make good the difference, equating to 6% of the gross income, or 9.09% of the income that they actually receive.

All "accumulated" income (i.e. income that is not paid out to the beneficiaries at the discretion of the trustees) that is paid out to the beneficiaries when the child reaches the appropriate age, is distributed "as capital", and does not attract any further income tax.

The distribution of the capital of the Trust is not a taxable event.

If a beneficiary dies before he is **entitled** to receive income or capital from the Trust, **no** part of the Trust's assets are brought into his/her estate for IHT purposes.

Post 2006 Budget

A&M trusts are treated like Discretionary Trusts (see above), **unless**;

- the trust is set up for a disabled person, or

- the trust is created on death by a parent for a minor child who becomes absolutely entitled at eighteen years, or

- the trust is created on death for one life tenant "in order of time" with absolute vesting thereafter,

in which case the trust will be taxed as before the 2006 Budget.

With regards to accumulation and maintenance trusts existing on 22 March 2006, those that are modified to provide for a vesting in a beneficiary ***absolutely*** at the age of eighteen will continue to be taxed under the pre-2006 Budget tax rules. Those that are not converted, will be taxed as Discretionary Trusts (see above) from 6 April 2008.

APPENDIX 3

“Flat-rate” tax deductions

Industry	Occupation	Deduction
Agriculture	All workers	70
Aluminium	a) Continual casting operators, process operators, de-dimplers, driers. Drill punchers, dross unloaders, firemen, furnace operators and their helpers, leaders, mouldmen, pourers, remelt department labourers, roll flatteners	130
	b) Cable hands, case makers, labourers, mates truck drivers and measurers, storekeepers	60
	c) Apprentices	45
	d) All other workers	100
Banks	Uniformed bank employees	40
Brass and Copper	All workers	100
Building	a) Joiners and carpenters	105
	b) Cement works and roofing felt and asphalt labourers	55
	c) Labourers and navvies	40
	d) All other workers	85
Building materials	a) Stone- masons	85
	b) Tile makers and labourers	40
	c) All other workers	55
Clothing	a) Lacemakers, hosiery bleachers, dyers, scourers and knitters, knitwear bleachers and dyers	45
	b) All other workers	30
Constructional Engineering	a) Blacksmiths and strikers, burners, caulkers chippers, drillers, erectors, fitters, holders up, markers off, platers, riggers, riveters, rivet heaters, scaffolders, sheeters, template workers, turners, welders	115
	b) Banksmen labourers, shop- helpers, slewers, straightners	60
	c) Apprentices and storekeepers	45
	d) All other workers	75

Electrical and Electricity Supply	a) Those workers incurring laundry costs only (generally CEGB employees)	25
	b) All other workers	90
Engineering	a) Pattern makers	120
	b) Labourers, supervisory and unskilled workers	60
	c) Apprentices and storekeepers	45
	d) Motor mechanics in garage repair shops	100
	e) All other workers	100
Food	All workers	40
Forestry	All workers	70
Glass	All workers	60
Heating	a) Pipe fitters and plumbers	100
	b) Coverers, laggers, domestic glaziers, heating engineers and their mates	90
	c) All gas workers, all other workers	70
Healthcare Staff	a. Ambulance staff in the NHS, on active service. private hospitals and nursing	110
	b. Nurses, midwives, homes chiropodists, dental nurses, occupational, speech, physios and other therapists, phlebotomists, radiographers.	70
	c. Plaster room orderlies, hospital porters, ward clerks, sterile supply workers, hospital domestics, hospital catering staff.	60
	d. Laboratory staff, pharmacists and pharmacy assistants.	45
	e. Uniformed ancillary staff maintenance workers, grounds staff, drivers, parking attendants and security guards receptionists and other uniformed staff.	45
Iron Mining	a) Fillers, miners and underground workers	100
	b) All other workers	75
Iron and Steel	a) Day labourers, general labourers, stockmen, time keepers, warehouse staff and weighmen	60
	b) Apprentices	45
	c) All other workers	120
Leather	a) Curriers (wet workers), fellmongering workers, tanning operatives (wet)	55
	b) All other workers	40

Particular Engineering	a) Pattern makers	120
	b) All chainmakers; cleaners, galvaniser, tinners and wire drawers in the wire drawing industry; tool-makers in the lock making industry	100
	c) Apprentices and storekeepers	45
	d) All other workers	60
Police Force	Uniformed police officers (ranks up to and including Chief Inspector)	55
Precious Metals	All workers	70
Printing	a) Letterpress Section Electrical engineers (rotary presses), electro-typers, ink and roller makers, machine minders (rotary), maintenance engineers (rotary presses) and	105
	b) Bench hands (P & B), compositors (Lp), readers (Lp), T &E section wire room operators, warehousemen (Ppr box)	30
	c) All other workers	70
Prisons	Uniformed prison officers	55
Public service	i) Dock and Inland Waterways	
	a) Dockers, dredger divers, hopper steerers	55
	b) All other workers	40
	ii) Public Transport	
	a) Garage hands (including cleaners)	55
	b) Conductors and drivers	40
Quarrying	All workers	70
Railways	(see the appropriate category for craftsmen, eg engineers, vehicle builders etc) All other workers	70
Seamen	a) Carpenters (Seamen) Passenger liners	135
	b) Carpenters (Seamen) Cargo vessels, tankers, coasters and ferries	130
	c) Other seamen Passenger liners	nil
	d) Other seamen Cargo vessels, tankers, coasters and ferries	nil
Shipyards	a) Blacksmiths and their strikers, boilermakers, burners, carpenters, caulkers, drillers, furnace men(platers), holders up, fitters, platers, plumbers, riveters, sheet iron workers, shipwrights, tubers, welders	115

	b) Labourers	60
	c) Apprentices and storekeepers	45
	d) All other workers	75
Textile prints	All workers	60
Textiles	a) Carders, carding engineers, over lookers (all), technicians in spinning mills	85
	b) All other workers	60
Vehicles	a) Builders, railway wagon etc repairers, and railway wagon lifters	105
	b) Railway vehicle painters and letters, railway wagon etc builders' and repairers' assistants	60
	c) All other workers	40
Wood and furniture	a) Carpenters, cabinet makers, joiners, wood carvers and woodcutting machinists	115
	b) Artificial limb makers (other than in wood), organ builders and packing case makers	90
	c) Coopers not providing own tools, labourers, polishers and upholsterers	45
	d) All other workers	75

APPENDIX 4

Capital Allowances

Capital allowances are a deduction for tax purposes.

You receive capital allowances on capital expenditure on assets including industrial buildings and plant and machinery (which includes fixtures and fittings, computers and related equipment and motor cars).

We will concentrate on the capital allowances that apply to the purchase of plant and machinery for the purposes of this Guide.

When you buy an asset

First Year Allowance

The "first year allowance" represents the tax deduction that you can claim in the year that an asset is purchased. It is calculated as a percentage of the asset's cost (**excluding** VAT).

The amount of the first year allowance depends on the size of your business and the type of asset that you have bought;

- All businesses can claim a first year allowance of 100% in relation to expenditure on specifically defined items – including designated energy saving plant and machinery, new electric cars and low carbon dioxide emission cars (up to 1 April 2008) and environmentally beneficial plant and machinery. See 8.13.2.below for more details.

- "Small businesses" can claim a special "first year allowance" of 50% for 2005/06 and 2006/07 on purchased capital items (i.e. plant and equipment, fittings and furniture, machinery), but **excluding** motor vehicles.

- "Medium sized business" can claim a special "first year allowance" of 40% for 2005/06 and 2006/07 on purchased capital items, but excluding motor vehicles

- "Large businesses" can only claim the standard capital allowance of 25% on purchased capital items.

- As far as motor vehicles are concerned, the first year allowances that are claimed by ***all*** businesses may be restricted - this matter is explained in more detail below.

Note: Businesses are "small" if they can satisfy two of the following three criteria;

- *Annual turnover of £11.2 million or less,*
- *Assets worth £5.6 million or less,*
- *250 or fewer employees.*

Note: Businesses are "medium" if they can satisfy two of the following three criteria;

- *Annual turnover of £11.2 million or less,*
- *Assets worth £5.6 million or less,*
- *250 or fewer employees.*

"Pools"

The cost of each asset, after deducting any first year allowance, is added to a "pool" of expenditure. Some assets have to be kept in separate "pools", but everything else goes into one "general" pool.

You are required to keep separate "pools" for;

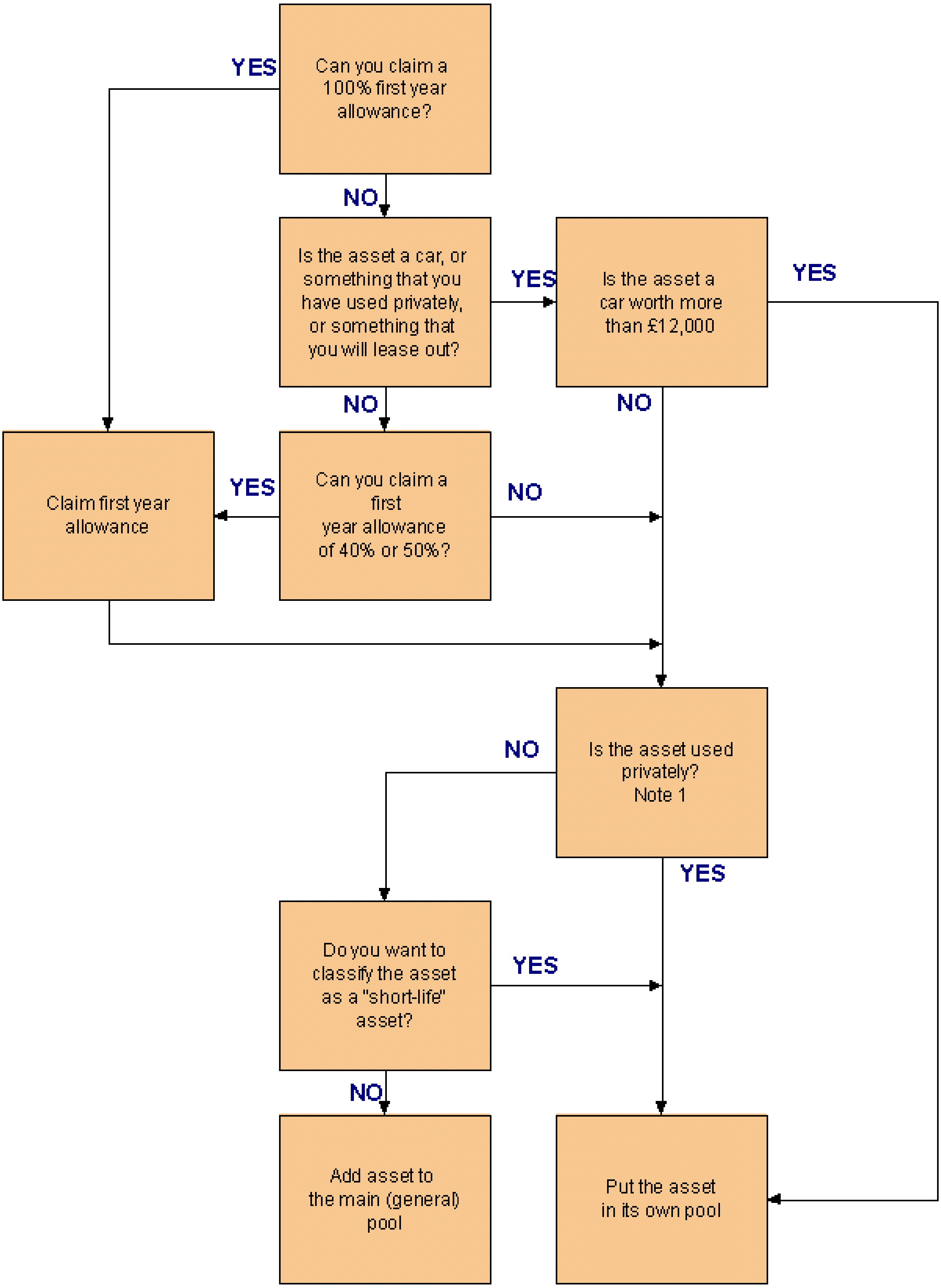
- Each "short-life" asset
- Each asset that you use for private as well as business purposes
- Each car bought for more than £12,000
- A general pool for every other asset

Diagram

The process of claiming first year allowances and "pooling" of assets is shown in Figure A1 below.

FIGURE A1

WHAT HAPPENS IN THE YEAR THAT YOU BUY AN ASSET



Each and every year

Writing Down Allowances

You are allowed to claim 25% of the "tax written down value" of an asset, each year, as a tax deduction. This is called a "writing down allowance". The "tax written down value" basically means the cost of the asset less any capital allowances claimed in previous years.

At the end of each accounting period, you calculate your writing down allowances on ***each*** pool as follows;

Step 1: Take the value of the pool at the end of the previous accounting period and add the cost of any new purchases, ***excluding*** the cost of those that qualify for first-year allowance

Step 2: Deduct the proceeds of any sale from the value of the pool, or the original cost of the item if less. If you give the item away, or start to use it for non-business purposes, the market value of the item is deducted from the pool. If the sale proceeds are more than the value of the pool, the difference is called a "balancing charge".

Step 3: Multiply the result by 25% to give your writing down allowance for the year. Deduct this allowance from the value of the pool.

Note: If you are calculating the writing down allowance on a car that has a tax written down value of more than £12,000, the written down allowance is capped at £3,000.

Note: If your accounting period is less than 12 months, the writing down allowance is adjusted accordingly. E.g if your accounting period is only 9 months long, you will only get a writing down allowance of 18.75%.

Step 4: Add the cost of any new purchases which qualified for first year allowances (after deducting the amount claimed as a first year allowance). The result is the value of your pool at the start of the next accounting period.

Tax Calculation

Your tax calculation will include the following items;

- A deduction for all of your first year allowances,
- A deduction for all of the writing down allowances for assets that are **not** used partly for private purposes,
- A deduction for each of the writing down allowances that relate to assets that **are** used partly for private purposes. The deduction is the writing down allowance multiplied by the business usage percentage. E.g. if you have calculated a writing down allowance of £2,000 on a car that you use 50% for private purposes, your tax deduction is £1,000 (although the tax value of your asset will be reduced by the full £2,000),
- A deduction for any balancing allowances,
- An addition for any balancing charges.

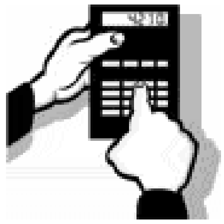
APPENDIX 5

Treatment of Business Expenditure for Tax purposes

The following list is written in general terms, so specific advice should always be taken. Refer also to the detailed Tips given in Sections 7 and 8 of this book.

Item	Deductible against Profits	Not Deductible
Normal business expenses generally	Expenditure incurred wholly and exclusively in the course of business	Personal expenditure and all entertaining except staff
Capital items (i.e. items expected to be used for more than 1 year)	An annual capital allowance is available on most items of equipment (see Appendix 5)	Freeholds and long leaseholds of most non-industrial premises
Computer software	If bought separately from hardware	If not bought separately, claim capital allowances
Gifts to customers	Gifts costing up to £50 and bearing the business name	Any item of food or drink
Home expenses	Reasonable proportion of home running expenses, depending on the extent of use of home for business	Domestic expenses not related to the business
Telephone bills	Business proportion based on calls	Private element and home line rental
Motor expenses	Business proportion based on mileage	Private element
Travel expenses	Business travel	Travel between home and normal place of business
Subscriptions	Professional subscriptions, relevant magazines and journals	Clubs, charities and items not associated with the business
Wages and salaries	Staff (including family where duties genuinely carried out)	Proprietor's own drawings and gratuitous wages to family
Bank charges and interest	Charges on business accounts and business related loans	Interest for personal overdrafts and loans
Other interest	Interest on business loans	Interest on income tax paid late and interest paid to proprietors
Insurance	Business related policies	Life assurance, self-employed NI, health and sickness insurance
Bad debts	Specific bad debts from unrelated parties	General provisions and debts written off voluntarily
Accountancy fees	Normal business related fees	Costs of unsuccessfully defending an Inland Revenue investigation
Legal fees	Most business related advice	Partnership agreements, company formation, property acquisition and renewing long leases
Personal expenditure	Modest subsistence expenses in certain cases when working away	Lunches, private expenses and bills, gifts, clothing (unless a uniform)

APPENDIX 6



Capital Gains Tax – Indexation Allowance

	Month											
Year	**Jan**	**Feb**	**Mar**	**Apr**	**May**	**Jun**	**Jul**	**Aug**	**Sep**	**Oct**	**Nov**	**Dec**
1982			1.047	1.006	0.992	0.987	0.986	0.985	0.987	0.977	0.967	0.971
1983	0.968	0.960	0.956	0.929	0.921	0.917	0.906	0.898	0.889	0.883	0.876	0.871
1984	0.872	0.865	0.859	0.834	0.828	0.823	0.825	0.808	0.804	0.793	0.788	0.789
1985	0.783	0.769	0.752	0.716	0.708	0.704	0.707	0.703	0.704	0.701	0.695	0.693
1986	0.689	0.683	0.681	0.665	0.662	0.663	0.667	0.662	0.654	0.652	0.638	0.632
1987	0.626	0.620	0.616	0.597	0.596	0.596	0.597	0.593	0.588	0.580	0.573	0.574
1988	0.574	0.568	0.562	0.537	0.531	0.525	0.524	0.507	0.500	0.485	0.478	0.474
1989	0.465	0.454	0.448	0.423	0.414	0.409	0.408	0.404	0.395	0.384	0.372	0.369
1990	0.361	0.353	0.339	0.300	0.288	0.283	0.282	0.269	0.258	0.248	0.251	0.252
1991	0.249	0.242	0.237	0.222	0.218	0.213	0.215	0.213	0.208	0.204	0.199	0.198
1992	0.199	0.193	0.189	0.171	0.167	0.167	0.171	0.171	0.166	0.162	0.164	0.168
1993	0.179	0.171	0.167	0.156	0.152	0.153	0.156	0.151	0.146	0.147	0.148	0.146
1994	0.151	0.144	0.141	0.128	0.124	0.124	0.129	0.124	0.121	0.120	0.119	0.114
1995	0.114	0.107	0.102	0.091	0.087	0.085	0.091	0.085	0.080	0.085	0.085	0.079
1996	0.083	0.078	0.073	0.066	0.063	0.063	0.067	0.062	0.057	0.057	0.057	0.053
1997	0.053	0.049	0.046	0.040	0.036	0.032	0.032	0.026	0.021	0.019	0.019	0.016
1998	0.019	0.014	0.011									

APPENDIX 7

Intestacy Rules

A. In England and Wales;

	Spouse and children survive	Spouse survives, but no children or grandchildren	No spouse survives
Personal effects	Spouse	Spouse	N/A
Legacies	£125,000 to spouse	£200,000 to spouse	N/A
Balance	50% of the remainder is held on trust to provide income to the spouse for life and, on the death of the spouse, the capital is split equally between all children The remaining 50% is held on trust in equal shares for the children until they are 18. If a child dies before they are 18, any surviving grandchildren take their share.	50% of the remainder to the spouse outright The other 50% to the parents outright. If no surviving parents, the amount is split equally between any surviving brothers and sisters, and, if none, their children. If there are none, the amount is given to the spouse outright.	Whole estate is given in order of priority to; - children, then grandchildren - parents - brothers and sisters (or nephews and nieces if they have died before you) - half-brothers and half-sisters (or their children if they have pre-deceased you) - grandparents - uncles and aunts (or their children if they have pre-deceased you) - half-brothers and half-sisters of your parents (or their children) - the Crown

B. In Scotland:

		Spouse and children survive	Spouse but no children survive	Children but no spouse survive	Neither spouse nor children survive
1	Home situated in Scotland	Spouse to £130,000 Any balance to children	Spouse to £110,000. Any balance per 5 below	-	-
2	Contents of home	Spouse to £22,000. Any balance per 4, then 5.	Spouse to £20,000. Any balance per 4, then 5.	-	-
3	Legacies	Spouse to £35,000.	Spouse to £58,000.	-	-
4	Balance of estate (excluding land and buildings)	1/3 to spouse 2/3 to children	½ to spouse ½ per 5 below	To children	-
5	Balance of estate (land and buildings)	To children	½ to surviving parents (or all if no brothers or sisters) ½ to brothers/ sisters (or all if no surviving parents) If none; to spouse	To children	½ to surviving parents (or all if no brothers or sisters) ½ to brothers/ sisters (or all if no surviving parents) If none, all to; - aunts and uncles (or children if pre-deceased) - grandparents - brothers and sisters of grandparents (or their descendants) - more remote ancestors - the Crown

BONUS 1

Inheritance Tax Planning Checklist

1	**Your financial position**	Prepare a statement of your assets and liabilities (see Bonus 2) Do the same for your spouse. Determine your current exposure to Inheritance Tax based on these statements
2	**Equalise estates**	Decide whether you need to, and want to, "equalise" the value of your assets between you and your spouse – i.e. the total value of your assets is split relatively evenly between you and your spouse.
3	**Keep records**	Keep a record of the location of all of your important documents, particularly those relating to each of the assets and liabilities listed in Step 1 above. Keep a record of the name and address of your tax office, accountant, solicitor, financial advisor, banker and doctor.
4	**Your will**	Check that you have a valid will and that it is up to date. Tell those people who you have appointed as executors where your will is kept. Check that your will provides guidance on appointing guardians for your minor children if they are left without parents.
5	**Write benefits "into trust"**	Make sure that any "death in service" or life assurance benefits that will be received on your death will not be treated as part of your estate for IHT purposes.
6	**Payment of IHT**	Determine how IHT will be paid on the death of you and your spouse and whether life assurance arrangements need to be changed to provide these funds.
7	**Your family's future**	Consider the financial position of your spouse and your children after you die. Have you made adequate provision for their future?
8	**Gifts**	Consider lifetime gifts. What scope do you have for making them? What can you afford without risking your own financial security? If possible, begin to make gifts regularly, utilising annual and other exemptions at least.
9	**Trusts**	Consider setting up a trust (or trusts) to provide for future generations.
10	**Charity**	Decide whether you should make gifts to charity, either during your lifetime or on your death, to reduce IHT.
11	**Receipt of inheritances**	Assess whether you or your spouse are likely to receive any significant inheritances in the future. If so, decide what to do with them. It may pay to gift them directly to your children or grandchildren.
12	**Subscriptions**	Keep a list of all of the subscriptions that you pay that will need to be cancelled on your death

BONUS 2

Statement of Assets and Liabilities

	You	Joint	Spouse	Total
ASSETS				
Home (after deducting mortgage)				
Home contents				
Motor cars				
Jewellery, art and antiques				
Other property (list) (after deducting mortgages)				
Cash				
Savings and deposit accounts				
Shares, stocks, bonds etc				
National Savings Investments				
Personal Equity Plans (PEPs)				
ISAs				
TESSAs				
Unit Trusts				
Investment Trusts				
Other investments (EIS, VCT etc)				
Share options				
Life insurance policies payable to your estate				
Other assets (list)				
TOTAL ASSET VALUE				
LIABILITIES				
Loans				
Overdrafts				
Credit cards				
Other liabilities (list)				
TOTAL LIABILITIES				
NET ASSETS				

Note: Include all amounts based on their current market value **– not cost.**

Note: The Statement of Assets and Liabilities should exclude those that will not be treated as part of your estate, namely death in service benefits, life policies written in trust, interests in trusts and future inheritances**.**

BONUS 3

Self-Assessment Calendar

Date	What happens	Who is affected
31 January 2006	Deadline for filing the Tax Return relating to 2004/05 Payment date for any balance of tax due for 2004/05 Payment date for the first payment on account due for 2005/06	Taxpayers sent a Return Taxpayers Taxpayers
1 February 2006	First penalty of £100 charged for late submission of the Tax Return relating to 2004/05	Taxpayers sent a Return
28 February 2006	First 5% surcharge on any tax outstanding from 2004/05	Taxpayers who have not paid all of the tax due for the previous year.
6 April 2006	Tax Return for 2005/06 sent out by Inland Revenue	Taxpayers who need to fill out a Return
31 July 2006	Second payment on account due for 2005/06 Second £100 penalty charged for failing to submit the tax return for 2004/05 Second 5% surcharge on any tax still outstanding for 2004/05	Taxpayers who make regular payments on account Taxpayers who have not sent in their tax return for the previous year Taxpayers who have not paid all of the tax due for the previous year
30 September 2006	Deadline for filing Tax Return for 2005/06	Taxpayers who want the Revenue to calculate their tax or who want their tax code to be adjusted for any tax due
31 January 2007	Deadline for filing the Tax Return relating to 2005/06 Payment date for any balance of tax due for 2005/06 Payment date for the first payment on account due for 2006/07	Taxpayers sent a Return Taxpayers Taxpayers
1 February 2007	First penalty of £100 charged for late submission of the Tax Return relating to 2005/06	Taxpayers sent a Return
28 February 2007	First 5% surcharge on any tax outstanding from 2005/06	Taxpayers who have not paid all of the tax due for the previous year.

BONUS 4

A Guide to Tax Credits

"9 out of 10 people are entitled to receive tax credits. And you do not have to have children to qualify"
***Source: Inland Revenue website*.**

You can apply for two tax credits, Child Tax Credit and Working Tax Credit.

You have to apply. It will not come to you automatically.

1. Are you eligible?

The general rule is that to qualify for tax credits you must be aged 16 or over and usually live in the United Kingdom.

You may also qualify if you do not live in the UK but you are

- A citizen of another country in the European Economic Area (EEA) and you work in the United Kingdom, or
- A Crown Servant posted overseas, or
- A citizen of a country in the European Economic Area (including the UK) living abroad and you receive a UK state pension or contributions-based Jobseeker's Allowance.

Couples **must** make a joint tax credits application. If you are part of a couple, you cannot decide to apply as a single person.

2. Child Tax Credit

Child Tax Credit is for people who are responsible for at least one child or qualifying young person.

You do not have to be working to claim Child Tax Credit.

Child Tax Credit is paid direct to the person who is mainly responsible for caring for the child or children. If you are a lone parent you will receive the payment. Child Tax Credit can be paid to workers who continue to pay UK National Insurance Contributions when posted from the UK to work in another country in the European Economic Area.

The amount of tax credit is dependent upon the number of children and the annual income of the claimant/couple.

All families with children with an income of up to £58,000 a year will be able to claim some Child Tax Credit, whether or not they are working (or income of up to £66,000 if you have a child under 1).

Appendix 1 is a "yes/no" flowchart that will make it easy for you to decide whether you are eligible to receive Child Tax Credit. Use it. It is dead simple.

3. Working Tax Credit

Working Tax Credit is a payment to top up earnings of working people on low incomes.

Working Tax Credit is for people who are employed or self-employed (either on their own or in a partnership), who;

- usually work 16 hours or more a week,
- are paid for that work, and
- expect to work for at least 4 weeks

and who are;

- aged 16 or over and responsible for at least one child, or
- aged 16 or over and disabled, or
- aged 25 or over and usually work at least 30 hours a week

Couples, if both of you are working 16 hours or more a week, must choose which one of you will receive it.

Three important points to note about Working Tax Credit;

- you cannot receive Working Tax Credit if you are not working.
- you do not have to have children to claim WTC.
- WTC amounts are not dependent upon the number of children that you have.

Appendix 2 is a “yes/no” flowchart that will make it easy for you to decide whether you are eligible to receive Working Tax Credit. Use it. It is dead simple.

4. How much can I get?

4.1 Child Tax Credit

The table below sets out the various elements of the Child Tax Credit for 2006/07.

Child Tax Credit	Per Year
Family element (note 1)	545
Family element, baby addition (note 1)	545
Child element (note 2)	1,765
Disabled child element (note 2)	2,350
Enhanced disabled child element (note 2)	945

Notes:

1. Only one family element is available per family. Families are entitled to the family element and the baby addition in the first year of a child's life.

2. As well as one family element, a family will be entitled to a child element for each child for whom it has responsibility. For each child, the child elements which are appropriate may be added together to arrive at the maximum amount available for that child.

These elements represent the ***maximum*** amount of Child Tax Credit that you can get.

ILLUSTRATION

If you are a family of 5, with one disabled child, your maximum Child Tax Credit would be;

Family element	545
Child element (2 x 1,765)	5,420
Disabled child element	4,115
Maximum Child Tax Credit	10,080

Your maximum Child Tax Credit is then reduced according to your income. How this is done is described later in this Guide.

4.2 Working Tax Credit

The table below sets out the various elements of the Working Tax Credit for 2006/07.

Working Tax Credit	Per Year
Basic element (note 1)	1,665
Additional couple's and lone parent element (note 1)	1,640
30 hour element (if claimant, or partner, or both together, work more than 30 hours per week) (note 1)	680
Disabled worker element (one per worker in a joint claim) (note 1)	2,225
Enhanced disabled adult element (if get highest rate DLA Care or highest rate AA). One per qualifying adult in joint Claim. (note 1)	945
50 plus return to work payment, 16-29 hours (note 2)	1,140
50 plus, return to work payment, 30+ hours (note 2)	1,705
Childcare element;	
- maximum eligible cost	300.00
- maximum eligible cost for 1 child	175.00
- percentage of eligible costs covered	80%

Notes

1. Apart from those mentioned in the footnote below, the elements for which claimants are eligible can be added together to arrive at the maximum amount of tax credit available.

2. These elements are mutually exclusive. Where an individual works enough hours to qualify for the 50plus return to work payment (30+ hours), they cannot also qualify for the 50plus return to work payment (16-29 hours).

As part of Working Tax Credit you may qualify for help towards the costs of childcare.

If you receive the **childcare element of Working Tax Credit**, this will always be paid direct to the person who is mainly responsible for caring for the child or children, alongside payments of Child Tax Credit.

The childcare element is worth up to 80% of eligible childcare costs up to a maximum of £175.00 per week for families who pay for childcare for one child and £300 per week for families who pay for two or more children. The amount you get will depend on your family income.

You are eligible for the child care element of the WTC if;

(i) You and your partner (if you live together) must each work for 16 hours or more per week, **or**

(ii) If you are a lone parent, you must work for 16 hours or more per week, **or**

(iii) You are one of a couple where one partner is working 16 hours or more per week and the other is incapacitated and you care for children of qualifying age and pay for childcare.

4.3 Calculation

Your Tax Credit entitlement is calculated in three steps;

Firstly, you need to calculate your income for the tax year,

Your income includes:

1. Employment earnings,
2. Allowances and benefits – Carer's Allowance, Incapacity Benefit, Industrial Death Benefit, Jobseekers Allowance – but not benefits which are not taxable,
3. Benefits in kind provided by employers (car and car fuel, allowances for the use of your own car on business, vouchers and credit tokens),
4. The first £100 of statutory maternity/paternity/adoption pay,
5. Interest and dividends (but **not** income from tax exempt investments),
6. Pension,
7. Income from abroad,
8. Winter Fuel Payments.

Items 5 to 8 are only brought in to the extent that they exceed £300.

Student loans and maintenance payments are excluded.

Your savings are not relevant to this calculation.

Secondly, you need to calculate your maximum entitlement to Child Tax Credit (see 4.1 above) and Working Tax Credit (see 4.2 above), and

Thirdly, you need to adjust your maximum entitlement according to your income.

The table below is relevant to this adjustment calculation.

2006-07 rates and thresholds

Common features	Per year
First income threshold	5,220
First withdrawal rate	37%
Second income threshold	50,000
Second withdrawal rate	1 in 15
First income threshold for those entitled to CTC only	14,155

Those with income below the first income threshold will be paid the full amount of tax credits available for their circumstances (being the "maximum" tax credit entitlement calculated in 4.1 and 4.2 above).

Those with income over the first income threshold will have the maximum tax credit entitlement reduced by 37p for every £1 that their income exceeds the threshold.

Claimants eligible for both WTC and CTC will have their maximum entitlement reduced in the following order:

- WTC apart from childcare,
- The childcare element of WTC,
- CTC apart from the family element; and finally,
- CTC family element where income exceeds the higher threshold of £50,000

This means that WTC paid through employers is the first to be withdrawn, so that for many families with children, tax credits will be paid wholly to the person with main responsibility for the child's care.

ILLUSTRATION

A couple with two children, where both parents work at least 16 hours per week and who are paying £320 a week on childcare will receive WTC and CTC calculated as follows:

Working Tax Credit:		
Basic element	1,665	
Second adult element	1,640	
30 hour element	680	
Childcare element (300 x 80% x 52)	12,480	16,465
Child Tax Credit		
Child element (1,765 x 2)	3,530	
Family element	545	4,075
Maximum Tax Credit entitlement		**20,540**

The maximum award is payable until family income reaches £5,220 (first threshold).

For income over this threshold, there is a taper of 37p for each additional £1 of income, so that, for example, the WTC basic element will be lost when income reaches

£5,220 + (£1,620 x 100/37) = £9,598

The CTC family element is subject to the higher threshold of £50,000, above which the taper is £1 for each additional £15 of income and will be lost when income reaches

£50,000 + (£545 x 15) = £58,175

The following table shows what credits are given to the couple at the various "threshold" levels of income (being the levels of income at which the various elements of the tax credits are lost):

Income	**Maximum Entitlement**	**Element that is lost**
5,220	20,540	
9,720	18,875	WTC – basic
14,152	17,235	WTC – second adult
15,989	16,555	WTC – 30 hour
49,719	4,075	WTC – childcare
58,175	Nil	CTC - family

So. if the couple earned gross income of £15,989 in the tax year, they would receive combined WTC and CTC of £16,555 and if they earned £49,719, they would receive CTC of £4,075.

5. Notes

Child Benefit is paid in addition to Tax Credits.

All credits will be based on annual income for the ***preceding*** tax year and will run for a full year.

Tax credits will be responsive to change during the year however increases or decreases in annual earnings of up to £2,500 will not affect the award.

After the end of each tax year, your entitlement to Tax Credits will be re-assessed and re-calculated. You will be asked to complete a form which, among other things, tells the authorities your actual income and relevant expenditure for the tax year. The information that you provide will be used to assess;

- whether you have received too much or too little Tax Credit for that tax year;
- your entitlement to Tax Credit for the new tax year.

If you received too much Tax Credit for the tax year, this will be deducted from the amount that you will be paid in the new tax year. If you received too little Tax Credit for the tax year, this will be paid directly to you once your form has been processed.

People aged 50 and over, returning to work for at least 16 hours after time spent on qualifying out of work benefits, can receive a higher rate of WTC.

Childcare providers will not need to endorse the childcare element of the WTC, however all claims for childcare will be checked with the provider by the Inland Revenue.

6. How will tax credits be paid?

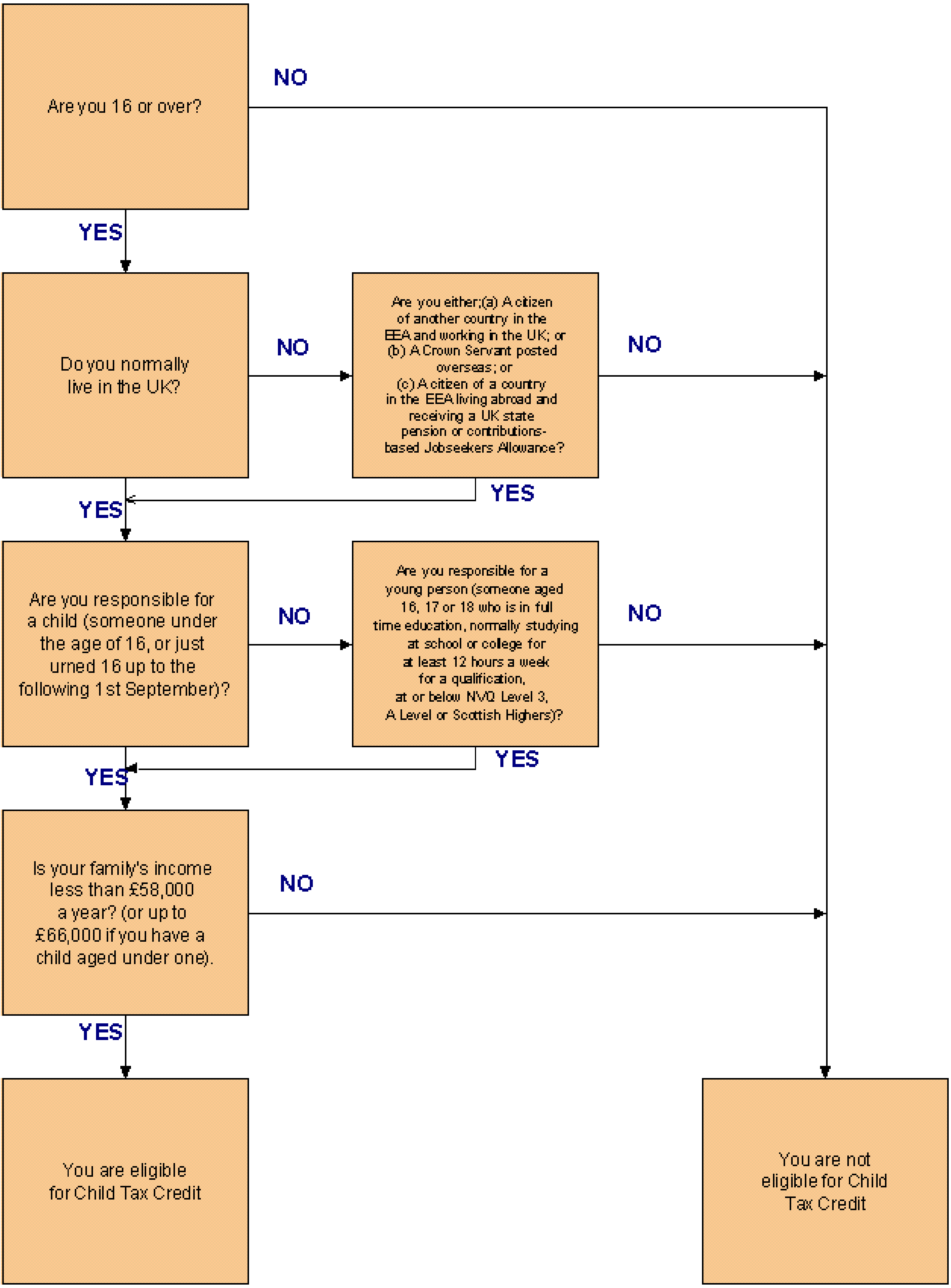
If you are employed, your employer will pay any Working Tax Credit (apart from the “child care element”) with your pay. Otherwise, tax credits will be paid directly to your bank or building society account.

7. How to claim Tax Credits

You should call 0800 500 222 between 7.00am and 11.00pm, seven days a week.

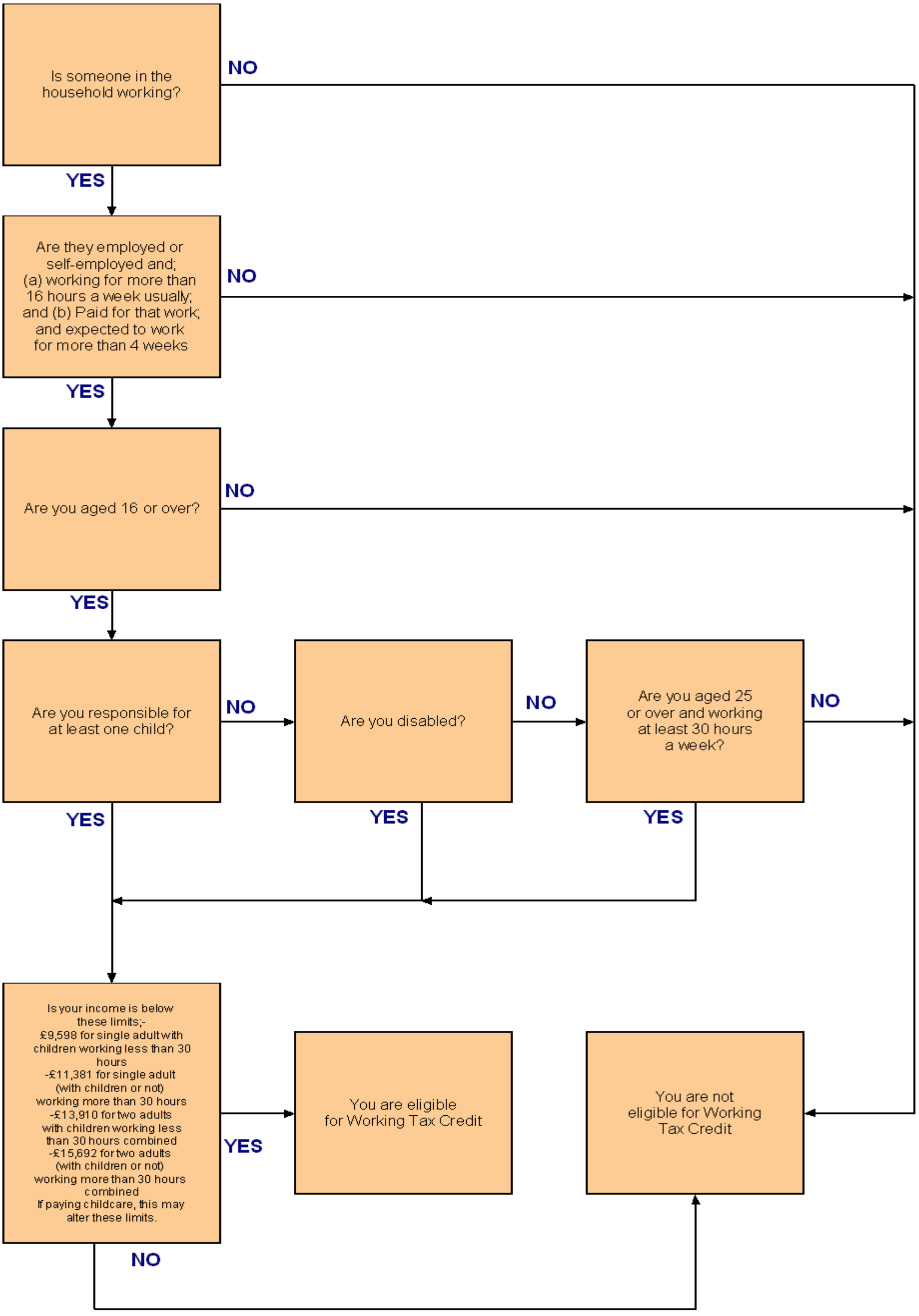
The Tax Credit Helpline can give you more information, you can call them on 0845 300 3900. Lines are open from 8.00am to 8.00pm seven days a week, and calls are charged at local rate.

CHILD TAX CREDIT CHECKLIST



BONUS 4. APPENDIX 2

WORKING TAX CREDIT CHECKLIST



BONUS 5

Standard letters

B5.1	**Bank interest paid request**	Request the details of interest paid on a loan account from your bank or building society. These details may be required on your tax return or repayment claim form.
B5.2	**Bank interest received request**	Request the details of interest received on an account from your bank or building society. These details may be required on your tax return or repayment claim form.
B5.3	**Extra time to pay on account**	Ask the Inland Revenue to postpone your tax payment. The Inland Revenue will require proof that you are unable to make this payment.
B5.4	**Flat rate expense claim**	Claim your flat rate expenses to the Inland Revenue.
B5.5	**Interest paid gross request**	Request an R85 form from your bank or building society that will allow you to have your interest paid without tax.
B5.6	**Notice of coding request**	Request your notice of coding from the Inland Revenue. This is required to check your tax code.
B5.7	**Notice of coding**	Request for a revised notice of coding to be issued by the Inland Revenue. This is necessary if there is a mistake on your existing notice of coding or if your financial circumstances have changed.
B5.8	**Repayment claim to Inland Revenue**	Submit a tax repayment claim form to the Inland Revenue.
B5.9	**Self-assessment payment on account**	A letter to accompany your payment of taxation on account to the Inland Revenue
B5.10	**Self-assessment tax return to Inland Revenue**	A letter to accompany your self assessment tax return when submitting it to the Inland Revenue.

B5.1 Interest Paid Request

<Your Address>

<Date>

The Manager
< Bank/Building Society address>

Dear Sir/Madam

<Your Name>
<Account Name(s)> - <Account Number(s)>

Please provide me with details of the interest paid on my above loan account(s) for the year ended 5th April <Year>.

Yours faithfully

B5.2. Interest Received Request

<Your Address>

<Date>

The Manager
< Bank/Building Society address>

Dear Sir/Madam

<u><Your Name></u>
<u><Account Name(s)> - <Account Number(s)></u>

Please provide me with details of the interest credited to my above account(s), together with any tax deducted at source, for the year ended 5th April <Year>.

Yours faithfully

B5.3. Extra time to pay on account

<Your Address>

<Date>

Your Ref: <Your tax reference>
<Your National Insurance Number>

H M Inspector of Taxes
<Inland Revenue address>

Dear Sir/Madam

<Your Name>
Payment on account due on 31st <January/July><Date *eg 2006*>

I am due to make a payment on account on 31st <January/July> <Date *eg 2006*>. However, I am unable to pay the tax in full by this date due to <Details of why you cannot pay on time>.

I should therefore be grateful if you would allow me to make the payment over the next <number> months. I understand that interest will accrue on the tax that remains unpaid and enclose a cheque for £<Value> in part payment.

I look forward to hearing from you in due course.

Yours faithfully

B5.4. Flat rate expenses claim

<Your Address>

<Date>

Your Ref: <Your tax reference>
<Your National Insurance Number>

H M Inspector of Taxes
<Inland Revenue address>

Dear Sir

<Your Name><Occupation>
Year ended 5th April <Year>

Would you please adjust my notice of coding to take into account the flat rate expense claim for £<Amount> in accordance with Extra-Statutory Concession A1.

I look forward to receiving an amended Notice of Coding in due course.

Yours faithfully

<Your Name>

B5.5. Interest Paid Gross Request

<Your Address>

<Date>

The Manager
< Bank/Building Society address>

Dear Sir/Madam

<u><Your Name></u>
<u><Account Name(s)> - <Account Number(s)></u>

I would like to register to have the interest paid on my above account<s> to be paid gross. Would you therefore please send me Registration form R85.

Yours faithfully

<Your Name>

B5.6. Notice of Coding Request

<Your Address>

<Date>

Your Ref: <Your tax reference>
<Your National Insurance Number>

H M Inspector of Taxes
<Inland Revenue address>

Dear Sir/Madam

<Your Name>
Notice of Coding for <Date *eg 2006/2007*>

To enable me to check my tax code, would you please let me have a copy of my notice of coding for the above year.

Yours faithfully

<Your Name>

B5.7. Notice of Coding

<Your Address>

<Date>

Your Ref: <Your tax reference>
<Your National Insurance Number>

H M Inspector of Taxes
<Inland Revenue address>

Dear Sir/Madam

<Your Name>
Notice of Coding for <Date *eg 2006/2007*>

I refer you to my Notice of Coding for <Date *eg 2006/2007*> issued on <Date>.

My code of <Code *eg 453L*> is incorrect as it <does not >/<should not> include the following:

<list items here, including description(s) and amount(s)>

I look forward to receiving an amended Notice of Coding in due course.

Yours faithfully

<Your Name>

B5.8 Repayment Claim to Inland Revenue

<Your Address>

<Date>

Your Ref: <Your tax reference>
<Your National Insurance Number>

H M Inspector of Taxes
<Inland Revenue address>

Dear Sir

<Your Name>
Repayment Claim for the year ended 5th April <Year>

Please find enclosed my repayment claim form for the year ended 5th April <Year>.

I look forward to receiving a copy of my tax calculation and any repayment of tax due to me in due course.

Yours faithfully

<Your Name>

enc.

B5.9. Self-Assessment Payment on Account

<Your Address>

<Date>

Your Ref: <Your tax reference>
<Your National Insurance Number>

H M Inspector of Taxes
<Inland Revenue address>

Dear Sir/Madam

<Your Name>
Tax Payment due on 31st <January/July><Enter Year>

Please find enclosed my cheque for £<amount> in respect of my payment on account due on 31st <January/July> <Year>, together with my payslip.

I look forward to receiving a receipt in due course.

Yours faithfully

<Your Name>

enc.

B5.10. Self Assessment Return to Inland Revenue

<Your Address>

<Date>

Your Ref: <Your tax reference>
<Your National Insurance Number>

H M Inspector of Taxes
<Inland Revenue address>

Dear Sir/Madam

<Your Name>
Self Assessment Tax Return for the year ended 5th April <Year>

Please find enclosed my Self Assessment Tax Return form for the year ended 5th April <Year>.

I look forward to receiving a copy of my tax calculation for the year in due course.

Yours faithfully

<Your Name>

enc.

BONUS 6

Tax Allowances

Tax allowances	2006/07	2005/06
Personal allowance	5,035	4,895
Value of Children's Tax Credit Value reduces for higher rate taxpayers	1,765	1,690
Over Age 65 – Personal Allowance	7,280	7,090
Over Age 65 – Married Allowance	6,065	5,905
Capital Gains Tax threshold	8,800	8,500
National Insurance		
Employees and Employers Weekly - Lower Limit	97	94
Employees Weekly - Upper Limit - 1% Above	645	630
Employees and Employers Annual - Lower Limit	5,044	4,895
Employees Annual - Upper Limit - 1% above	33,540	32,760
Employees Rate	11.0%	11.0%
Employers Rate	12.8%	12.8%
Class 2 - Self Employed @ £2.10 per week	4,465	4,345
Class 4 - Self Employed @ 8% above	5,035	4,895
Tax Rates		
10% on first	2,150	2,090
22% on next	31,150	30,310
Higher Rate at 40% on taxable earnings over	33,300	32,400

BONUS 7

Financial Glossary

Don't be confused by jargon any longer

A

Accountant	A person whose job it is to prepare accounts. They can also give you tax advice and liase with the Inland Revenue on your behalf. There are several different types of Accountant, so check up on their qualifications before you use one. For example, someone with the designated letters 'ACA' (or 'FCA') is a Chartered Accountant and an 'ACCA' (or 'FCCA') is a Chartered Certified Accountant,
Accounting date	The date when an accounting period ends. For example, if your accounting period runs from 1 January 2005 to 31 December 2005, the accounting date would be 31 December 2005. Also called the accounting "year end".
Accounting period	The period for which accounts are prepared. An accounting period should not normally be longer than 18 months.
Accruals	Adjustments made in your accounts at the end of your accounting period, being provisions for income earned but not yet billed, or for expenses incurred but not yet paid. Examples are the amount of sales you have made but which you have not yet been paid for, and the cost of electricity which you have used but have not paid for, even if you have not yet been billed for it.
Accruals basis of accounting	A method used for preparing accounts, which adjusts for accruals at the beginning and end of the accounting period, so that the income included in your accounts is that earned during the accounting period, and the expenses are those incurred during the accounting period. The alternative method of accounting is the "Cash basis".
Accrued income	The amount of interest that has been accrued on Treasury Stock (and other similar investments) when you buy it. For tax purposes, you are allowed to deduct this accrued income from any interest that you actually receive, in calculating the amount of interest income that you pay tax on.
Additional voluntary contributions	You can make "additional voluntary contributions" to enhance your pension if you belong to an employer's pension scheme. You can pay these additional contributions into your employer's pension scheme or to your own FSAVC Scheme (Free Standing Additional Voluntary Contributions).
Administrators	The persons appointed to administer your estate if you die without a will. Also known as Personal Representatives
Allocation	A term used to describe the procedure of putting shares aside for a specific employee as part of a Share Incentive Plan. Shares may be "allocated" as a result of the employee buying them out of their pre-tax salary or the employer giving them to the employee.
Allowable business expenses	Expenses incurred in the running of your business, which you may deduct from your trading income (or turnover) before calculating your taxable profit and loss. See also "tax deductible".
Allowable deductions	Inland Revenue approved deductions that you can deduct from your net income to reduce your tax liability.
Allowable expense	An expense that you can deduct from your income or capital gains. For example, you can deduct allowable business expenses from trading income, and allowable rental expenses from the income from letting property. Your tax liability will be calculated on the net income (gross income minus allowable expenses) or on the net gains (gross capital gains minus allowable expenses).
Allowance	A deduction, or relief, which you may be able to claim depending on your circumstances. Most people can claim a personal allowance, but other allowances available are the married couple's allowance, and the blind person's allowance.
Allowance restriction	Where a tax allowance is given to you at a restricted rate, and not at your highest rate of tax. Tax relief on the married couples allowance, for example, is restricted to only 10% of the allowance.
Annual exemption	

	make gains of £8,800 (for 2006/07) before you need to pay capital gains tax. For inheritance tax purposes, you are allowed to give away £3,000 per annum without the gifts being taken into account.
Annuity	A sum of money which is payable regularly. You can pay a lump sum to an insurance company to buy an annuity. The insurance company pays you an income, usually for the rest of your life. The amount of income is fixed at the outset. You cannot usually get your lump sum back. Pensions from Retirement Annuity Plans and Personal Pension Plans are usually paid as annuities.
Arising basis	This term means that you are taxed on income based on the date when the income is due. You do not have to receive it to be taxed on it.
Asset	Something of long term value that you own, such as shares in a company, a property, an item of jewellery, an antique, or even something intangible.
AVC's	Acronym for Additional Voluntary Contributions.

B

Bad debts	If a customer of a business fails to pay the bill for goods or services received, the unpaid amount is a "bad debt". Although the sale is included in your turnover, the bad debt is an allowable expense.
Balance Sheet total	A term used in the classification of companies as “small” or “medium”, which determines what type of accounts need to be filed at Companies House and whether these accounts need to be audited. Balance Sheet Total means the aggregate of the amounts shown as assets in the balance sheet (**before** deducting both current and long-term liabilities).
Balancing allowances	A type of capital allowance that may be given if you sell an asset for less than its tax written down value. Balancing allowances are not given on items of plant that are included in the general capital allowances pool until the business ceases. A balancing allowance will reduce the tax that you have to pay.
Balancing charge	A withdrawal of some or all of the capital allowances previously given. A balancing charge arises when an asset stops being used in your business, and it is generally calculated as the difference between any disposal proceeds and the tax written down value of the asset. Balancing charges may be made on the general capital allowances pool if the proceeds of sale of pooled assets exceed the tax written down value of the whole pool. A balancing charge will increase the tax that you have to pay.
Base rate	Most interest rates are linked to the Base Rate. The Bank of England meets monthly to decide what the base rate should be set at. The base rate determines how much other banks and building societies pay for loans they take out from the Bank of England. These base rates in turn affect the interest rate you pay for loans.
Basic rate	For 2006/07, the basic rate of income tax is 22%. You pay tax at the starting rate (10%) on the first £2,150 of your taxable income (the starting rate band), at the basic rate (22%) on any income between £2,150 and £33,300 (the basic rate band), and tax at the higher rate (40%) on any income in excess of £33,300. However, the basic and higher rates of tax are slightly different for savings and investment income, such as interest and dividends. To the extent that your interest from banks or building societies falls within the basic rate band it is taxed at 20%. To the extent that interest income falls into the higher rate band it is still taxed at 40%.To the extent that your dividend income falls within the basic rate band it is taxed at 10%. To the extent that dividend income falls into the higher rate band it is taxed at 32.5%.
Basic Rate taxpayer	A “basic rate taxpayer” is a person whose taxable income for the tax year is lower than the “higher rate threshold”, but is more than the “basic rate threshold” (£2,150 for 2006/07).
Basis period	The period used to identify the profits of a business that are taxable in any particular tax year. Normally the Basis Period is the same as the accounting period, but special rules apply in the first three tax years of trading, on a change of accounting date, and on cessation.
Bed and Breakfasting	Where assets (normally shares) are sold and then bought again shortly afterwards to avoid Capital Gains Tax.
Beneficiary	Someone who receives a benefit from someone or something. Most commonly used to refer to a person who receives income or capital from a trust, or from the estate of a deceased person.
Benefits in kind	Part of your remuneration package as a company employee, but not paid in cash. Includes the use of company assets such as company cars, low interest loans and so on. Also called “taxable benefits”, “perks” and “fringe benefits”
Blind person's allowance	A tax allowance you are entitled to if your sight has failed and you are registered as blind (registers do not exist in Scotland or Northern Ireland).
Bond	A bond is a promise to repay an amount that has been borrowed (called the “principal”) along with interest (normally called “coupons”) on a specified date.
Bonus	An extra reward paid by employers to employees either at a certain time of the year such as at Christmas, or in recognition of a good performance. The bonuses can be anything from cash to a holiday or a valuable asset.

Business	Broadly, you are in business if you are trading with a view to making a profit. There are criteria to differentiate between a business and a hobby. If in doubt, contact the Inland Revenue, an Accountant or a Tax Adviser.
Business expenses	The costs that a business has incurred in earning its profits. Not all business expenses are allowable for tax purposes.
Business income	The income of a business, as earned from sales, fees, commissions etc.
Business travel	Travel between places of work, or to a place of work to carry out duties there, but excluding private travel and ordinary commuting.

C

Capital allowances	Tax deductions that are given in respect of the cost of certain fixed assets, including plant and machinery and industrial buildings. Balancing charges may be imposed if you sell an asset for more than its tax written down value. Balancing allowances may be given if you sell an asset for less than its tax written down value.
Capital gain	The profit that you make (after deducting certain expenses and other reliefs) if you dispose of a chargeable asset (also called a “Chargeable Gain”).
Capital gains expenses	These include costs of buying and selling an asset. For example, fees charged by stockbrokers or auctioneers and any initial valuation costs. These expenses can be deducted in the calculation of the capital gain or loss on the disposal of the asset.
Capital gains indexation allowance	An adjustment for inflation between the date you bought an asset and the date it is sold. For individuals, this allowance was frozen with effect from 6 April 1998.
Capital gains tax	Tax charged on capital gains that you have made.
Capital growth	The increase in the price (or value) of an asset, for example an increase in the price of a share.
Capital loss	The loss that you make when you dispose of a chargeable asset.
Carry back	Sometimes you can claim for a loss you have made, or for a payment you have made, to be deducted from your income or capital gains in a tax year earlier than that in which the loss or payment was made. For example you may claim for a trading loss to be set against your income in the tax year before that in which you made the loss. This procedure is called “carry back”.
Carry forward	Sometimes losses cannot be fully tax relieved in the year they were made. The unused amount is carried forward for tax relief in a later tax year. Some unused reliefs, such as unused personal pension relief can be carried forward, but only for a specific period of time.
Cash basis	A method used for preparing accounts which only includes income actually received during the accounting period and expenses actually paid during the accounting period. Some businesses use a modified cash basis, including income when it is received, but including expenses on an accruals basis. The alternative method is the “Accruals basis”.
Cash equivalent value	If your employer provides you with a benefit in kind in the form of an asset, or the right to use an asset, its taxable value is called the cash equivalent value.
Chargeable assets	Assets which, when sold, are subject to capital gains. This includes assets such as shares, second homes, investment properties, works of art worth more than £6,000. Some assets are not liable to capital gains tax when sold. Examples are your main residence (subject to certain conditions regarding periods of absence and business use), motor cars, and gilts.
Chargeable gains	See “Capital Gain”
Charity	An organisation which raises funds to pass on to people in need, for educational purposes, for the advancement of religion or for the general benefit of the community.
Child Tax Credit	Child Tax Credit was introduced in April 2003 (along with Working Tax Credit) to replace the previous system of children’s and working family's tax credits. Broadly speaking, anyone who earns less than £58,000 in 2006/07 and who had dependent children is entitled to receive Child Tax Credit. Child Tax Credit is paid to the person mainly responsible for looking after the child/children (normally direct into their bank account).
Child Trust Fund	Special savings accounts for all children born after 31 August 2002 that have operated from April 2005. The Government will contribute up to £500 to start up these accounts. The money is “locked in” until a child reaches 18. The money cannot be obtained before then. The accounts operate like ISAs and all income and capital growth earned in the account are tax-free.
[illegible]	[illegible]

Contributions	employee. They grant entitlement to contributory social security benefits. Employers also pay Class 1 and 1A National Insurance Contributions, but these do not grant entitlement to social security benefits.
Class 2 National Insurance Contributions	Weekly national insurance contributions that you must pay if you are self-employed or in partnership. They grant you entitlement to some contributory social security benefits.
Class 3 National Insurance Contributions	Weekly national insurance contributions that you may pay voluntarily to build up entitlement to some contributory social security benefits.
Class 4 National Insurance Contributions	National insurance contributions charged on your business profits if you are self-employed, and on your share of partnership business profits if you are trading in partnership. They do not grant you any additional entitlement to social security benefits.
CO2 emissions	Carbon Dioxide emissions. The tax that you pay on a company car is determined by the level of its Carbon Dioxide emissions
Company car	A car which is provided for you by your employer.
Compensation	A sum of money you receive if you give something up such as your employment or the right to use an asset.
Concession	Something which the Inland Revenue allows in practice, although it would not strictly be allowed under the terms of the tax legislation. For example luncheon vouchers of up to 15p per day are tax free under an Inland Revenue concession.
Contracted-in	You are “contracted-in” if you are not a member of your employer's contracted-out pension scheme and you do not contribute to an appropriate personal pension plan. (You will receive a State Second Pension if your earnings exceed the national insurance lower earnings limit). You will pay a slightly higher level of National Insurance contributions if you are Contracted-in, as opposed to Contracted-out (see below).
Contracting-out	The act of opting out of the State Second Pension, either through membership of your employer's contracted-out pension scheme, or by contributing to an appropriate personal pension plan.
Contributions	Sums of money which are paid towards something. Commonly used to refer to payments into schemes, such as pension schemes, Save As You Earn (SAYE) schemes and so on.
Corporate Bonds	These are issued by companies when they want to raise money. They are loans which the company agrees to repay at or between set dates.
Council tax	Payable to your local council in return for services and amenities. The amount payable depends upon your council, the value of your house and what council tax band it falls into.

D

De minimis	A lower limit below which you need not do something. For example, if you have given your children money and they receive interest on that money, you do not need to include that income in your Tax Return if it is less than a de minimis limit of £100.
Debtors	People who owe you money. Under the accruals basis of accounting, you will include in your accounts any sales that you have made, even if you have not collected the money for them. If you have a balance sheet, debtors will appear as an asset of your business.
Deducted at source	If tax is deducted from income before you receive it, this is termed “deducted at source”. This commonly applies to bank and building society interest and wages.
Deduction	Something which reduces the amount of your taxable income or your chargeable gains. A business expense is a deduction that can be used to reduce the amount of your taxable business profits. Indexation allowance is a deduction that can be made in the calculation of your chargeable gain on the disposal of an asset.
Deed of Covenant	A legal document which records the obligation of one individual to pay a specified sum to another for a specified number of years. The individual making the payment deducts tax at the basic rate and thus pays a net amount on which tax relief is obtained. If the recipient is a registered charity the payer can obtain tax relief up to his/her higher rate whilst the charity can claim back the amount deducted.
Dependent child	Any child under 16, or a child aged 16 or over who is in full time education or who needs full time care.
Depreciation	A deduction from business profits made to write off the cost of a fixed (or capital) asset over its expected useful life. Depreciation is not an allowable expense for tax purposes, but assets are given an equivalent tax deduction through capital allowances.
Director	One of at least two individuals appointed by a company’s shareholders to run the business. A company’s directors have to be registered with Companies House.
Disallowable expenses	Expenses which, although charged in your business accounts, are not tax deductible. The disallowable expenses must be added on to your trading profits when you calculate your taxable profits.
Discretionary trusts	Trusts where the Trustees can choose how to allocate the income and/or capital between the beneficiaries. They may also have the power to accumulate income rather than paying it out to beneficiaries every year. The trustees' powers are specified by the Trust Deed.
Dispensation	An agreement between an employer and the Inland Revenue that particular expenses paid to employees are genuine business expenses. The expenses are not reported on the forms P11D or P9D and must not be included on the employees' own Tax Returns.
Disposals	Term used for the sale, gift, loss or exchange of an asset or part of an asset.
Dividend	Money which is paid by a company or unit trust manager to a shareholder or unit holder. The payment is made out of accumulated profits.
Dividend yield	A measure of the money that you earn from owning a share, calculated by dividing the dividend paid per share by the current market price of the share
Domicile	Your domicile is the country where you intend your permanent home to be. This can be different from the country you currently live in.
Double taxation agreement	An agreement between governments of two countries to resolve taxation issues. They are designed to stop income being taxed twice.
Double taxation relief	Taxation relief given where income would otherwise be taxed in two countries.

Drawings	Distribution to the owner(s) of a sole trader or partnership; similar to dividends for a corporation
Dual resident	A term used to describe you if you are Resident in two or more countries at the same time.

E

Earnings	See “emoluments”
EIS	Acronym for Enterprise Investment Scheme.
Elections	You can make an election if you want your income or gains to be taxed in an alternative way. There are strict time limits for elections, and you must normally satisfy specific conditions before you can use the revised treatment. Elections that you can make include the allocation of the married couple's allowance between spouses, the appointment of a particular house as your main residence and the treatment of assets that you owned on 31 March 1982 as if you had bought them on that date.
Emoluments	The amount of income you receive from your employment. This income includes your salary, commissions, benefits (such as the provision of a company car) and payments of expenses (such as travelling and subsistence costs).
Employed	If you work for someone else, then you are employed. Refer to Section 8.17 in the Guide for further guidance on how to distinguish between an employed and a self-employed person.
Employee	A person who is employed by an employer under a contract of service whether written or implied.
Employer	Someone who employs you to do a job under a contract of service.
Employment income	The earnings you receive from your employment.
Endowment policy	A type of life insurance policy that pays out upon the death of the insured within a period, or at the end of the period if the individual is still alive. If the policyholder dies during the endowment period, a payment is made to a beneficiary
Enterprise Investment Scheme	The Enterprise Investment Scheme is an Inland Revenue approved scheme that encourages individuals to subscribe for shares in unquoted trading companies. Tax relief is due on the investment. There are many detailed rules applying to this scheme.
Entertainment	Hospitality provided, such as dinners, parties, business lunches etc.
Equities	A common term applied to shares in companies.
Estate	Property left by a person who has died. The executors will collect all the assets of the estate and distribute them to the beneficiaries in accordance with the terms of the dead person's will, or intestacy rules if no will has been left.
Executor	An individual (or individuals) who is appointed in a will, or by a Court, to distribute the assets of the deceased’s estate.
Exempt	Income that is not taxable. For example, prizes from the National Lottery or winnings from gambling.
Exercise	To take up an option to buy something - usually a share.
Ex-gratia	An ex-gratia payment is one made freely where there is no obligation to make any payment. Often made by employers to leaving employees.
Expenses	Outgoings you incur in the running of your business, as a result of your employment, or on the purchase or sale of an asset.

F

Filing date	The date by which you must file your Tax Return. The normal filing date is 31st January following the end of the tax year but, if you wish the Inland Revenue to calculate your tax bill, you should file your Tax Return by 30th September
Finance lease	A non-cancellable lease, where the contract period is close to the life of the asset, and the lessee pays all of the maintenance and servicing costs
First year allowances	Capital allowances that you can claim on certain fixed assets in the year that you acquire them. First year allowances are not available to large businesses, nor are they available on cars (except in a car hire business).
Fixed Asset	A tangible asset that will be used for business purposes for a long period, generally defined as more than 2 years. Also called “Capital assets”
Flat rate deduction	If you buy and maintain special clothing and tools that you have to use in your employment the expense is tax deductible. Instead of claiming a deduction for the actual amount you spend, you can claim a flat rate deduction. The amount of the flat rate deduction depends on the nature of your employment and is agreed between the Inland Revenue and your trade union or association (see Appendix 3).
Foreign income	Income from non-UK sources
Forms	There are many types of forms which are issued by the Inland Revenue for completion in certain circumstances.
Free standing additional voluntary contributions	If you are in an employer's pension scheme you can make extra pension contributions, called additional voluntary contributions. These may be made into your employer's scheme, or into a separate pension scheme of your choice. Contributions to your own scheme are called free-standing additional voluntary contributions.
Freelance	In business on your own, selling your own services.
Friendly society	An organisation set up to accept savings from individuals.
Fringe benefits	See “Benefits in kind”.
FSAVC's	Acronym for Free Standing Additional Voluntary Contributions.
FTSE - 100 share index	An index run by the London Stock Exchange which monitors the performance of the top 100 UK quoted companies on the London stock exchange.
Furnished holiday lettings	Holiday accommodation in the UK which is furnished, available for commercial letting for at least 140 days per year, let commercially as holiday accommodation for at least 70 days per year and not occupied for a continuous period of more than 31 days by the same person for a period of at least 7 months of the year

Gains	Profits that are made on the disposal of investments (such as shares) and other assets. The profits made are normally liable to capital gains tax, but in some cases are liable to income tax.
Gift	Something which is received, or made, voluntarily.
Gift Aid	Gift Aid allows a Charity to claim, from the Inland Revenue, the basic rate of tax on a donation made by a tax-paying donor, as long as that donor has made a "Gift Aid" declaration. The amount received by the Charity amounts to 28p for every £1 given by the donor.
Gilts	Treasury stock and other loan stock issued by the Government. These stocks are known as Gilt-edged securities (Gilts) because the Government guarantees the repayment of your capital. Interest will be paid to you, normally at a rate fixed when the gilts were issued. Some gilts are index linked.
Gross	Used to describe amounts that are paid or received without deduction of any tax.
Grossing-up	The term given to the process of adding back the tax deducted to the net income to calculate the gross income.
Guardian	A person that you appoint in your will to take care of your minor children

Higher rate tax	For 2006/07, the higher rate of income tax is 40%.
Higher Rate taxpayer	A “higher rate taxpayer” is a person whose taxable income for the tax year is more than the “higher rate threshold” - as some of his/her income is taxed at the higher rate
Higher Rate threshold	For 2006/07, the Higher Rate threshold is £33,300.
“Home to work” travel	Travel from your home to your place of work. Any costs of such travel are not generally allowable for tax purposes unless you can show that your home is your business base, or your permanent workplace if you are an employee.

I

IFA	Acronym for Independent Financial Adviser.
Income	Something you receive from working, from assets you own (such as shares), or a government benefit paid to you.
Income for tax purposes	Income which is liable to tax. Some forms of income are tax free, such as winnings from gambling (providing you are not a professional gambler) or the National Lottery.
Income from employment	See Employment Income.
Income generating asset	An asset which gives you an income, such as shares which pay dividends, land which pays rent, cash in a savings account that pays interest, and so on.
Income limit	For some reliefs and allowances there is a limit to the amount of the relief or allowance that you can claim which is related to the amount of your taxable income.
Income tax	A tax on the income you receive. For 2006/07, there are five different rates of income tax (10%, 20%, 22%, 32.5% and 40%) based on how much income you earn and from what source.
Independent Financial Adviser	An Independent Financial Adviser is someone who can give you advice about a wide range of financial products. They must be authorised to give advice, and are regulated by the Financial Services Authority.
Index Linked	Something that rises in line with movements in an index, such as the Retail Prices Index
Indexation allowance	An allowance which reduces the taxable element of a chargeable gain to allow for the rate of inflation. The indexation allowance has been frozen at 5 April 1998 and replaced by Taper Relief.
Individual Savings Account	An investment vehicle which allows you to invest in stocks, shares and life assurance policies, or to hold cash, and earn income and gains tax-free. There is no minimum period that you have to invest for in order to qualify for tax relief, but amounts of capital withdrawn cannot be replaced except by using a further years ISA allowance.
Inheritance	Something you receive from a deceased relative or friend. Inheritances are received free of income tax and capital gains tax and should not be entered on your Tax Return.
Inheritance tax	A tax payable on your assets when you die. For 2006/07, no inheritance tax is payable if your total assets, including your home, are worth less than £285,000. 40% tax is payable on the excess over this amount. Some lifetime gifts may be liable to inheritance tax, although gifts you make to another individual are free of inheritance tax if you do not die within seven years of making the gift.
Inland Revenue	The government department which controls the collection of income tax, capital gains tax, inheritance tax and so on.
Interest	Money you pay on a loan or receive if you have cash deposits. Personal overdraft interest or credit or charge card interest is not tax deductible.
Intestacy	If a person dies without leaving a will, the assets of the deceased's estate pass under the intestacy rules.
Investment income	Income generated from assets such as shares, land and property and cash deposits.
Investments	An asset that you buy for its income and/or its capital growth.
ISA	Acronym for Individual Savings Account

J, K, L

Joint tenancy	If you own land and property with one or more persons, your ownership is normally a joint tenancy. On the death of a joint tenant, their share automatically passes to the other joint tenants. In Scotland the equivalent of a joint tenancy is pro indiviso (indivisible) common ownership. See also “Tenants in Common”.
Lease	A **lease** is a temporary transfer of the right to use an asset from the owner of the asset (the “lessor”) to someone else (“the lessee”) in exchange for a “rent”
Lease or rental expenses	Where property or land is let, you can set most expenses for the letting and upkeep of the land or property against the rental income. Expenses include some legal costs, accountancy fees, repairs and so on.
Lessee	See “lease”
Lessor	See “lease”
Let property	Property that you allow someone else to use, usually in return for the payment of rent. You may own the property yourself, or you may lease it from a landlord, and sublet it to your tenant.
LIBOR	Acronym for London Inter Bank Offer Rate. This is the rate charged by banks on loans between themselves.
Life insurance policies	Policies which will pay a lump sum to a beneficiary or your executors on your death. Some policies also have an investment content, which means that when the policy comes to an end, you will receive a payment whether or not you have died. If the death benefits are written under trust, they are not included in your estate for Inheritance Tax purposes.
Loans	A sum of money lent to another party who agrees to repay the amount over a period of time and usually to pay interest on the outstanding balance.
Loss	A loss arises when the income or proceeds received are less than the expenses or cost. There are detailed rules on how tax relief can be claimed on losses.
Lower paid employee	An employee who is paid at a rate of less than £8,500 a year, including the value of all benefits and reimbursed expenses, but excluding all Directors. Such employees are not taxed on certain fringe benefits.
Lump sum and compensation payments or benefits	Payments made to you when you leave your employment, or when the terms of your employment are significantly altered, and benefits which your former employer makes available to you after leaving. These payments and benefits are generally taxable if made under the terms of your contract of employment, but there is tax relief for payments resulting from an accident at work, foreign service and for the first £30,000 of compensation payments

M

Main residence	The place where you normally live and consider to be your home. For capital gains tax purposes, you can elect for your “main residence” to be any property that you own.
Maintenance	A payment made to a former spouse or child, following divorce or legal separation. Tax relief may be claimed by the payee while the amount may have to be included in the taxable income for the recipient.
Market value	The price which you can obtain for an asset if you sold it freely on the open market.
Mileage allowance	An allowance paid to you by your employer for business travel in your own car. It is based on the number of business miles you travel and is paid at a rate fixed by your employer.

N

National insurance	A scheme which provides pensions and other social security benefits. Some benefits are dependent on contributions you have paid, whilst other benefits are means tested. Employees pay higher contributions and have a greater entitlement to benefits than do the self-employed. Contributions are also payable by employers.
National Insurance Contributions Office (NICO)	A department of the Inland Revenue which has responsibility for administering the collection and recording of national insurance contributions.
National Insurance number	A unique reference number which is used to identify your national insurance contribution record and entitlement to social security benefits.
National Savings and Investments	A savings organisation backed by HM Treasury which offers a number of different savings products. Information on these is available from your local Post Office as well as from National Savings.
Net	A term used to refer to an amount of money that you receive after tax has been deducted. May also be used to refer to income after the deduction of expenses.
Net Relevant Earnings	Your taxable earnings from your self-employment, or from an employment where you are not a member of your employer's pension scheme. You may make contributions to a Retirement Annuity Plan or Personal Pension Plan, up to a percentage of your net relevant earnings. The percentage limits are based on your age, and differ between Retirement Annuity Plans and Personal Pension Plans.
Nominee	A person who holds assets for another person.
Non-resident	Someone who is not resident in the UK for tax purposes.
Non-taxpayer	Someone who does not pay tax because their income is too low.
Not domiciled	Broadly, you will not be UK Domiciled if you were born outside the UK and/or you do not consider the UK to be your permanent home.
Not ordinarily resident	If you are not resident in the UK year after year, you are not ordinarily resident.
Not resident	You are not resident in the UK if you spend less than half the year in the UK, or if you spend less than 3 months of each year in the UK on average.
Notice of coding	The notification of your PAYE code that you receive from the Inland Revenue.

O

Occupational Pension Scheme	A pension scheme run by a company for the benefit of its employees.
Operating lease	A short-term, cancellable lease. A type of lease in which the contract period is shorter than the life of the asset being leased, and the lessor pays all maintenance and servicing costs
Option	The right to buy or sell something at a set price within a given time period. Employees for example, may be granted options to purchase shares in the company that employs them.
Ordinarily resident	If you are resident in the UK year after year, you are "ordinarily resident".
Overlap profit	Business profits that have been taxed twice because part of an accounting period falls within the basis period for more than one year.
Overlap relief	Tax relief that is given for overlap profits brought forward. It is given either on a change of accounting date or, if the Basis Period is longer than12 months, on the cessation of a trade.
Overseas	A country other than England, Northern Ireland, Scotland and Wales.

P

P11D	A form detailing the expenses and benefits paid to you, which must be sent to the Inland Revenue by your employer if you are either a director or an employee who earns more than £8,500 a year. Your employer must give you your copy of your P11D for the year ended 5th April 2006 by 6th July 2006.
P45	A form which must be given to you if you leave your employment during the tax year. It sets out the tax has been deducted from your pay by your employer in the current tax year. You should retain part 1A of the form for your records but give parts 2 and 3 to your new employer.
P60	An annual certificate detailing your income, tax deducted and national insurance for your current employment, as well as any earlier employments in the same tax year. The P60 is given to you by your employer at the end of the tax year.
Partnership	A relationship between two or more people who are in business together.
Pay As You Earn	Pay As You Earn is the system under which your employer deducts income tax from your pay during the year. It is a sophisticated system as it takes into account your personal allowances and the different tax rates and tax bands. The tax deducted must be shown on your payslip, and on the P45 which is given to you when you leave that employment, or on the P60 form which is given to you at the end of the tax year.
PAYE	Acronym for Pay As You Earn.
PAYE code	Your PAYE code informs your employer how you should be taxed. In calculating your tax code, the Inland Revenue take into account your tax allowances, your benefits in kind, your untaxed income and, if you wish, any amounts of unpaid income tax from earlier years.
Payment on account	A tax payment made during the year "on account", which is based on your tax bill for last year. A repayment or further tax liability arises when you complete your Tax Return and finalise your tax bill for the year.
Payroll Giving	A scheme which gives you tax relief for payments you make to a registered charity. The payments are deducted from your pay by your employer and paid to a charitable agency. You can then choose which charities you wish to make donations to.
Pension	A pension is a regular payment to you from a pension scheme once you have retired or have reached an age when you are entitled to draw that pension.
Pension contributions	Payments you make to a pension scheme. This may be your employer's pension scheme, or your own retirement annuity plan or personal pension plan. In return you will receive a pension once you have retired. Contributions are tax deductible (subject to certain limits).
Pension income	Regular payments you receive from a pension scheme.
Pension scheme	A vehicle, normally managed by a pensions company or a board of trustees, which will collect pension contributions from its members, invest this money in a mixture of assets, and pay out pensions to members when they retire.
Perks	See “Benefits in Kind”.
Permanent workplace	A workplace which you attend regularly to carry out your employment duties. Not a temporary workplace. A permanent workplace includes a base which you attend daily to receive a list of your duties. You may not have a permanent workplace or you may have more than one.
Personal allowance	Everyone is entitled to receive an amount of income before being liable to tax. For 2006/07, the personal allowance is £5,035.
Personal Pension Plans	If you are employed but are not a member of your employer's pension scheme, or are self

	pension provider and how the funds are invested. Your contributions to your personal pension plan are subject to set limits based on your age and your Net Relevant Earning. Payments to a personal pension plan qualify for tax relief.
PET	Acronym for Potentially Exempt Transfer
Plant and Machinery	The apparatus or equipment which you use for your trade. This does not include the premises in which you trade, such as your factory or shop, or the goods which you process or sell, such as raw materials and stock. It does include machinery used in your factory, display counters in a shop, cars, lorries and vans used for business purposes by yourself and your employees, computers and other office equipment, and so on. The cost of plant and machinery is not tax deductible, but you can claim capital allowances instead.
Pool of assets	You may add together amounts you spend on most items of Plant and Machinery, deduct the proceeds of items you have sold, and calculate your capital allowances on the total expenditure. The term "pool of assets" is used to cover all Plant and Machinery where the expenditure has been aggregated. A separate pool must be maintained for cars costing more than £12,000, short-life assets and assets where there has been private use.
Potentially Exempt Transfer	If you make a gift during your lifetime, it could be liable to inheritance tax. Some gifts are exempt from inheritance tax, such as gifts to your spouse, and the first £3,000 of other gifts each tax year. Other gifts you make to individuals will be exempt, provided you do not die within 7 years of the gift. Such gifts are Potentially Exempt Transfers and you will not know until 7 years have passed whether they are exempt or not, although you treat them as exempt in the meantime. Inheritance tax may become payable if you do not survive for the full 7 years.
PPP	Acronym for Personal Pension Plan.
Premium Bonds	A national savings scheme backed by HM Treasury similar to a lottery. You buy bonds, which participate in regular draws until you cash in your bonds. Any winnings are tax-free and should not be entered on your Tax Return.
Profit	The term used to describe the amount of income received after deducting all the expenses paid out in earning that income. May also be used to describe the amount you receive on the sale of an asset after deducting the cost of the asset and any expenses that you incurred in buying or selling that asset.
Provisional	A figure in your Tax Return which is estimated because the final figure is not yet available. If your Tax Return contains a provisional figure, you must tell the Inland Revenue what the final amount is as soon as it is known.

Q, R

Quoted	A share that is listed on a Stock Exchange. This means that you can buy and sell the share on the open market through a broker.
Recipient	Someone who receives something. Also “transferee”.
Redundancy	Leaving your employment because your employer no longer has work available for you to do. Redundancy can be voluntary where employees are offered the choice of leaving, or compulsory, where employees are dismissed.
Redundancy payments	Payments made to employees who leave after being made redundant (compulsory or voluntarily). Depending on the length of the employment for the person made redundant, there may be a statutory minimum payment.
Relief	Something which reduces your taxable income. A relief may also reduce your tax liability although your taxable income is not reduced.
Remittance basis	A basis of taxing certain foreign income and gains, which means that you will only pay UK income tax if the income or gain is brought into the UK.
Rent	Amount paid for occupying land and/or property owned by someone else.
Rent a room	Scheme under which you can receive an income of up to £4,250 from letting out rooms in your own home without paying any tax.
Repairs and Maintenance	Work carried out to preserve the condition of land and property, plant and machinery, fixtures and fittings and so on. These are allowable tax deductions provided there is no element of improvement in the repair. If there is, the expenditure can be split between repairs and maintenance (allowable) and improvements (disallowable).
Resident	You are resident in the UK if you spend at least half the tax year in the UK, or if you spend at least three months per tax year in the UK on average. You may be resident in the UK if you spend less time in the UK, but you will not be resident if you have not been in the UK at all during the tax year.
Retail Price Index	Published monthly by the government and based on a selection of goods and services which measures increases and decreases in prices. It is used to calculate the indexation allowance for capital gains, although the allowance has been frozen on 5 April 1998. Also used to increase personal allowances and tax bands automatically, unless the Government overrules the increase.
Retirement	You are retired if you have stopped working through choice. Although most people generally retire in their 50s or 60s, you can retire at any age.
Retirement Annuity Plans (or RAP)	These provide a pension when you retire. No new RAPs have been sold since 1 July 1988. You may still contribute to a pre - 1988 RAP if you are not in an employer's pension scheme, or you are self-employed or in partnership. You can choose how the funds are invested. Subject to set limits based on your age and your net relevant earning, payments qualify for tax relief.
Return	The money that you make (both income and capital gain) from owning an investment
Roll-over relief	A capital gains tax relief given to you when you sell assets used in your business and purchase new assets. It enables you to defer paying capital gains tax on the proceeds that you have reinvested until the replacement assets are sold. Only applies to certain assets including land and buildings, fixed plant and fixed machinery, and goodwill.
RPI	Acronym for the Retail Price Index

S

Salary and wages	Regular amounts of income paid to you by your employer under your contract of service, often weekly, 4-weekly or calendar monthly.
Savings	Generally refers to deposits made with a bank or building society. Does not include land and property held as an investment.
Self-assessment	The system under which you are required to complete a Tax Return and calculate your tax liability for the year.
Self-employed	You are self-employed if you are in business on your own account. See Section 10.17 in the Guide for advice on how to distinguish between an employed person and a self employed person.
Selling costs	The costs of selling a capital asset, such as land and property, shares and so on. Includes charges made by auctioneers, stockbrokers, estate agents, solicitors and so on.
Separated	You are separated if, although still married, you are no longer living together with your spouse.
Settlor	A person who transfers assets into a trust, or who makes a settlement.
Share option schemes	Schemes under which you are granted options to buy shares at a set price and at a set time or within a set period. The schemes *may* be approved by the Inland Revenue, in which case you will receive certain tax reliefs on income and gains that you receive from owning and selling the shares. If they are not approved by the Inland Revenue, the tax reliefs will not apply.
Share options	Rights given to you, which entitle you to buy shares at a set price and at a set time or within a set period.
Shares	The ownership of a company is divided between its members, who will each own a number of shares in that company. There can be different types of members (shareholders) with different rights represented by different classes of shares.
Social Security (or State) pensions	Pensions paid to you by the Department for Work and Pensions. Your entitlement to such a pension depends on your national insurance contributions and whether you have contributed towards the State Second Pension.
Stakeholder Pension	Stakeholder pensions are a type of low-cost personal pension, designed to ensure that moderate earners have access to private pension provision.
Starting Rate band	For 2006/07, the starting rate of tax applies to the first £2,150 of your taxable income. This is referred to as your starting rate band.
Starting rate	For 2006/07, the starting rate of income tax is 10%. You pay tax at the starting rate (10%) on the first £2,150 of your taxable income (the starting rate band).
State pensions	Pensions paid to you by the Department of Social Security. Your entitlement depends on national insurance contributions you have made and whether you have contributed towards an earnings related pension.
State Second Pension	The State Second Pension (S2P) is designed to top up your basic state pension income to perhaps as much as £500 per week, depending on how much you've earned over the years. It is “earnings-related” because the more you earn, the more you'll pay in National Insurance contributions, so the more you'll get. The S2P replaced the previous regime, the State Earnings Related Pension Scheme (SERPS), in April 2002. Many people are “contracted-out” of S2P, which means that part of your National Insurance payments, which would have gone towards providing your S2P benefits, get paid into your occupational or personal pension instead.
Stock	Raw materials used in your business for and goods bought for resale, which you have on hand.

Sub-Contractors	People who are not employees who carry out work for other people. The term is usually used to refer to workers in the building industry.
Subscriptions	Amounts you pay regularly to belong to a trade union or association, professional body or club.
Subsistence	Meals, refreshments and accommodation taken whilst working away from your normal place of work.
Sum Assured	The benefit payable under a life assurance policy.
Surplus allowance	The unused part of a tax allowance, such as your married couple's allowance and/or blind person's allowance, that arises because of insufficient income. It can be transferred to your spouse

T

Take home pay	The **pay** actually received by an employee after adding bonuses and deducting taxes
Tangible	Normally used to describe assets that have a physical existence, i.e. that you can touch.
Taper relief	Relief given for inheritance and capital gains tax, the amount of which is dependent upon the type of asset and the length of time between making the gift and death (inheritance tax) or between purchase and sale (capital gains tax).
Tax Adviser	Someone who can handle your personal taxation affairs and deal with the Inland Revenue on your behalf.
Tax code	See PAYE code
Tax credit	Although tax is not actually deducted from certain types of income, you may be given a tax credit as if tax had actually been deducted. For example, you are given a notional dividend rate tax credit on dividends you receive.
Tax inspector	An Inland Revenue employee whose job it is to check the accuracy of Tax Returns
Tax month	The period running from the 6th day of the month to the 5th day of the following month.
Tax office	The Inland Revenue has many tax offices situated around the UK. Your records will be held by one tax office which may not be geographically close to you. You can visit any tax enquiry centre for advice or to pay your tax.
Tax Return	The form that you may have to submit to the Inland Revenue, which includes details of all of your income and gains for a tax year as well as any claims for tax reliefs and allowances.
Tax year	The year running from 6th April one year to 5th April the following year. The tax year 2006/2007 is the year ending on 5th April 2007.
Taxable	Income and gains are taxable if you are liable to pay income tax or capital gains tax on them.
Taxable benefit	See “Benefits in Kind”.
Taxable income	Income which you are taxed on by the Inland Revenue. The term is often used to refer to your total taxable income, which is the aggregate of all your income less deductions and reliefs, and then minus your personal allowances.
Tax-free	Income and gains are tax free if they are exempt from income tax and capital gains tax. Examples are interest on National Savings certificates, lottery prizes and so on. Tax-free gains include gains on the sale of your home (subject to certain restrictions), cars and shares held in ISAs.
Tenants in Common	If you own land and property with one or more persons, you may own the property as “tenants in common”. This means that, if you die, your share of the property does not pass automatically to the other owner(s) - you can leave your share of the property to someone else in your Will. In Scotland the equivalent of tenancy in common is separable common ownership.
Term	A period, or length of time
Tools of trade	Equipment which traders use to carry out their trade.

Trade	Alternative name for a business. Any activity commercially run with a view to making a profit will normally be treated as a trade.
Trade creditors	Money you owe other businesses for goods or services you have received, but which remain unpaid at your accounting date.
Trade debtors	Money you are owed for goods you have sold or work you have done that is included in turnover, but remains unpaid at your accounting date.
Transferee	Someone who receives something from someone else (the “transferor”)
Transferor	Someone who transfers something to someone else (the “transferee”)
Trust	An arrangement where trustees (those responsible for the trust) hold assets for the benefit of particular people (the beneficiaries). The Trust Deed will set out how the trustees must deal with the income and capital of the trust.
Trust Deed	A legal document that sets out how a Settlor wants the Trustees to manage and distribute the assets that he/she places in Trust for the benefit of the Beneficiaries.
Trustee	A person who holds, manages and invests assets for the benefit of another (the “beneficiary”).
Turnover	Money earned by your business before deducting any business expenses. It includes receipts in cash or in kind for goods sold or work done, commission, fees receivable, tips, insurance proceeds for loss of stock and profits, and so on. It does not include amounts received from the sale of capital items, that is assets which are of lasting use to the business, such as business premises, plant, machinery and vehicles, nor value added tax.

U, V, W, X, Y, Z

Unemployed	You are unemployed if you are not working, either as an employee or as a person who is self-employed.
Unit trust	A unit trust is a trust that invests its funds in a mixture of shares and/or fixed interest securities. A professional manager runs the portfolio. You buy units in the unit trust, the amount you pay being added into the unit trust's funds. The price you pay for the units is based on the value of the unit trust's investments. You can sell your units back to the unit trust at any time.
Unlisted	Unlisted shares are shares that are not listed on a Stock Exchange. Same as “Unquoted”.
Unquoted	See “unlisted”
Unquoted trading company	A company which trades and is not quoted on a recognised stock exchange. Companies which hold assets for long-term gain are not trading companies (they are investments companies). Most private companies are unquoted trading companies.
Value added tax (VAT)	A tax which must be charged by VAT registered businesses on goods and services which they supply. VAT registered businesses must pay to HM Customs and Excise any VAT that they charge on their sales (outputs), but can normally deduct VAT they have paid on goods purchased for the business (inputs).
VCT	Acronym for Venture Capital Trust.
Venture Capital Trust	A Venture Capital Trust (VCT) is a quoted company which invests in unquoted trading companies. You can buy shares in VCT rather than in the underlying companies, thereby spreading your risk. To encourage investment of this type, various tax reliefs are given by the Inland Revenue if you invest in an approved VCT.
Wear and tear	An allowance that is tax deductible for the cost of furniture and fittings provided in dwelling houses which are let out furnished.
Withholding tax	Foreign tax which is deducted in the foreign country when income is paid to you.
Working Tax Credit	Working Tax credit was introduced in April 2003 (along with Child Tax Credit) to replace the previous system of children’s and working family's tax credits. Broadly speaking, Working Tax Credit is a payment to top up earnings of working people on low incomes. You do not have to have children to claim WTC.
Write off	The procedure of reducing the value of an asset for accounts purposes, to reflect what the asset is worth.
Writing down allowances	Capital allowances given against tax for the cost of certain fixed assets on a year-by-year basis. May be replaced by first year allowances in the year the expenditure is incurred, and by a balancing allowance or balancing charge in the year the asset is sold.
Written down value	The cost of an asset, such as a car, after deducting amounts written off. For tax purposes it is the cost less any capital allowances given to date.
Year End	See “Accounting Date”